

STATE OF CALIFORNIA
ELECTRICITY OVERSIGHT BOARD

PUBLIC MEETING

THURSDAY, AUGUST 31, 2000

CALIFORNIA STATE CAPITOL
ROOM 447
SACRAMENTO, CALIFORNIA
10:05 A.M.

Reported By:

Sandy Hopper
CSR 7110

CAPITOL REPORTERS
2340 Harvard Street
SACRAMENTO, CA (916) 923-5447

1 A P P E A R A N C E S

2
3 BOARD MEMBERS PRESENT:

4 MICHAEL KAHN, Chairman
5 BRUCE G. WILLISON

6 EXECUTIVE DIRECTOR:

7 GARY HEATH

8 CHIEF COUNSEL:

9 ERIK SALTMARSH

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

CAPITOL REPORTERS
2340 Harvard Street
SACRAMENTO, CA (916) 923-5447

1 SACRAMENTO, CALIFORNIA

2 THURSDAY, AUGUST 31, 2000, 10:05 A.M.

3 ---oOo---

4 CHAIRMAN KAHN: Good morning. I think we'll
5 get started.

6 The Legislature is still in session, but not
7 for long, which accounts for the absence of our
8 legislative members, who we'll excuse on that basis.
9 And we'll proceed. But before proceeding, I have
10 just a couple of opening remarks.

11 This last month has been very trying for
12 everyone. It's been very difficult for the ISO. I
13 know that people in the ISO have been working very
14 hard to deal with the exigencies that have arisen.
15 It has also been remarkably stressful for our
16 fledgling agency, who nobody seemed to think existed
17 last year and now we can't get through the phone
18 because the phone's always busy. And I would like to
19 begin the meeting by acknowledging and stressing
20 appreciation for the very small but very hard-working
21 staff of the EOB who have been trying their best to
22 keep up with the demands and the requests both from
23 the Administration and from the Legislature and from
24 the public.

25 And so, Mr. Heath, would you please convey our

CAPITOL REPORTERS
2340 Harvard Street
SACRAMENTO, CA (916) 923-5447

3

1 appreciation for that effort?

2 MR. HEATH: I will do that, Mr. Chairman. And
3 we appreciate the kind words.

4 CHAIRMAN KAHN: Okay. To my right is Bruce
5 Willison. Mr. Willison and I comprise the
6 Electricity Oversight Board. I believe we have a
7 quorum with two out of the three voting members here.

8 Is that right, Mr. Heath?

9 MR. HEATH: That is correct.

10 CHAIRMAN KAHN: Okay. Mr. Heath, do you want
11 to present the agenda?

12 MR. HEATH: I will.

13 Mr. Chairman, Member, thank you very much.
14 I'm Gary Heath, the Director of the EOB.

15 Our first item on the agenda today is the
16 approval of the minutes from the past two Board
17 meetings, that of June 29th and that of, I believe --
18 is that correct? -- June 29th and August 1st. Those
19 two are in your binders, Mr. Chairman, and under Tab
20 No. 1, and would ask for the Board's approval of
21 those minutes.

22 MR. WILLISON: Move it be approved.

23 CHAIRMAN KAHN: I second the motion.

24 All in favor?

25 Aye.

1 MR. WILLISON: Aye.

2 CHAIRMAN KAHN: Motion passes two to nothing
3 to approve the minutes.

4 Thank you.

5 MR. HEATH: Very good.

6 Mr. Chairman, Member, there -- Item No. 2 is a
7 Finance Committee Report. This report was prepared
8 at the request of the Chair to the Chair of the
9 Finance Committee. I will at this point turn it over
10 to Mr. Willison for his comments on the report.

11 MR. WILLISON: Thank you.

12 I had a chance to review the -- both the
13 results of the previous year's budget performance as
14 well as the budget that was submitted to the
15 Legislature and approved by the Legislature. A
16 couple of things that I would mention. The good news
17 for our taxpayers in that in last year's budget, the
18 EOB was actually able to return close to half a
19 million dollars worth that was underspent from the
20 approved budget, mostly driven, actually, by the
21 vacancies that were created and not filled during the
22 course of the year. As we've discussed at these
23 meetings, it's very difficult to fill these positions
24 particularly in the tight economy.

25 The budget was submitted to the Legislature

1 and approved basically at the same level some time
2 ago. In the meantime, with all of the extra work
3 that has been going on as part of the
4 responsibilities of the board and the staff, we have
5 determined that there is actually a need for
6 additional positions. And so, therefore, we have
7 prepared budget change proposals that need to be
8 submitted for additional positions, requesting
9 funding of those positions, a couple of other minor
10 issues related to other types of expert witnesses or
11 data-processing assistance. And so we have a motion
12 as part of this report which is that because of the
13 extra requirement for analysis and oversight
14 activities that we are submitting budget change
15 proposals to the state, Department of Finance. And
16 our motion is to direct the staff to submit these
17 VCPs to the Finance Department requesting
18 approval.

19 CHAIRMAN KAHN: Mr. Heath, when do they have
20 to be submitted?

21 MR. HEATH: They need to be submitted by
22 September 7th.

23 CHAIRMAN KAHN: I would -- I read them, and I
24 don't remember reading what I'm about to mention. If
25 I did, I apologize for the oversight. It seems to me

1 that the Governor's Task Force, which he asked the
2 EOB to participate in, has been very active and looks
3 like it will continue to be quite active. And I
4 think we have a significant role in that. I don't
5 know whether your BCPs reflect the additional burden
6 that has been assumed by the EOB as a result of that.
7 If they don't, I would suggest perhaps you augment
8 slightly to make those points.

9 MR. HEATH: Thank you, Mr. Chairman. I think
10 in our preparation of the BCPS we did not contemplate
11 that part of the workload. I will go back and
12 revisit that, and I will take it up -- take the issue
13 up with Mr. Willison, if it's okay with you. And if
14 we need to make an adjustment, you know, perhaps we
15 will have the okay based upon Mr. Willison's okay to
16 make those changes in the budget.

17 CHAIRMAN KAHN: And similarly, as we speak,
18 the Legislature is doing its work. And to the extent
19 that the outcome of the Legislature's work is
20 additional responsibilities for your organization or
21 for your staff, I think you should reflect that,
22 also.

23 MR. HEATH: Thank you, Mr. Chairman. We will
24 certainly take that up as we -- or as the new
25 Legislature comes forward, we will look at the fiscal

1 impacts to the board and report back to the board on
2 that and request any changes as appropriate.

3 CHAIRMAN KAHN: And while I'm on that subject,
4 although, it's a collateral subject, I would
5 appreciate your instructing our board, including the
6 legislative members as to the effect of any
7 legislation that occurs this month.

8 MR. HEATH: Very good. We will do that.

9 CHAIRMAN KAHN: With that friendly amendment,
10 Mr. Willison, I will move that report of the Finance
11 Committee and represented authorizations be adopted.

12 MR. WILLISON: Second.

13 CHAIRMAN KAHN: All in favor?

14 Aye.

15 MR. WILLISON: Aye.

16 CHAIRMAN KAHN: That passes two to nothing.

17 Is that sufficient, Mr. Heath?

18 MR. HEATH: That takes care of it. Thank you
19 very much.

20 CHAIRMAN KAHN: Next item is the Management
21 Report.

22 MR. HEATH: Yes. Thank you, Mr. Chairman,
23 Member.

24 We have four items to report on today. The
25 first one I wanted to take up was a letter that was

1 received addressed to the Oversight Board, to its
2 Director, a letter of August 28th, 2000, from the
3 Northern California Power Agency. It is a letter
4 addressing the ISO proposal for 10-minute
5 settlements, which are to begin, I believe, on
6 September 1, tomorrow. And at this point, I think I
7 would like to have a representative from NCPA to come
8 forward to address the Board on this matter. And
9 then I think we should provide some opportunity for
10 Mr. Winter or one of his staff to respond to NCPA's
11 request.

12 CHAIRMAN KAHN: Welcome.

13 But before we start that, what other items are
14 you contemplating that are in the Management Report?

15 MR. HEATH: Yes.

16 CHAIRMAN KAHN: Go ahead and have a seat, sir.

17 MR. HEATH: Thank you, Mr. Chairman.

18 I am going to also report on the pending
19 legislation related to the activities of the Board
20 under Assembly Concurrent Resolution now pending
21 before the Legislature. Also, I believe that
22 Mr. Saltmarsh may be able to inform the Board of
23 Senator Sher's Bill that is being dealt with today, I
24 believe. The other one is a status on the action
25 taken pursuant to the four resolutions approved by

1 the Board on August 1st. And the fourth one and
2 final will be an update on the current investigations
3 of the wholesale electricity market and proposed EOB
4 Report on that by November 1, 2000.

5 CHAIRMAN KAHN: Okay. Would you be kind
6 enough to introduce yourself, sir.

7 MR. Yes, sir. My name is --

8 MR. ROBINSON: Mr. Chairman, I apologize.

9 CHAIRMAN KAHN: Yes.

10 MR. ROBINSON: The person from the ISO who was
11 going to address this point appears to have been
12 detained. If we could perhaps defer this for ten
13 minutes, we'd appreciate it.

14 CHAIRMAN KAHN: Anything for you,
15 Mr. Robinson.

16 MR. ROBINSON: Thank you.

17 MR. HEATH: I'll go slow.

18 CHAIRMAN KAHN: That's okay. You can go fast.
19 We'll still be here.

20 MR. HEATH: Thank you very much.

21 Mr. Chairman, Member, in your package today is
22 a proposed resolution -- concurrent resolution
23 basically instructing both the California Public
24 Utilities Commission as well the Electricity
25 Oversight Board to conduct some studies and

1 investigations related to pricing of energy --

2 CHAIRMAN KAHN: Where is this?

3 MR. HEATH: This would be in your book -- just
4 a second.

5 Ms. Howell, do the Members have a copy of that
6 resolution?

7 MS. HOWELL: They should have.

8 CHAIRMAN KAHN: Oh, this is under Tab 3, the
9 Assembly Concurrent Resolution?

10 MS. HOWELL: Yes.

11 CHAIRMAN KAHN: Okay. Mr. Heath, I think we
12 have it.

13 MR. HEATH: Okay. Very good.

14 We do not know the full status of the
15 resolution. Things are moving quite rapidly within
16 the Legislature at this point, as you are well aware.
17 We just want to bring this to your attention since
18 it, in fact, called out the Oversight Board to
19 conduct potentially certain studies related to the
20 Ancillary Services of pricing and the pricing in the
21 energy markets. It's just an informational piece at
22 this point. We will report back to the Board on the
23 status of that concurrent resolution as it moves
24 through both Houses.

25 CHAIRMAN KAHN: Mr. Heath, to the extent that

1 this requires action by the Board, I take it you
2 could have between-meeting authorization of some
3 kind? Or do we have to have a shortened-notice
4 meeting?

5 MR. HEATH: I'm sorry, Mr. Chairman?

6 CHAIRMAN KAHN: My question is the legislation
7 seems to request the EOB do something.

8 MR. HEATH: That's correct.

9 CHAIRMAN KAHN: And if we want to do it
10 forthwith in response to the Legislature, we will
11 need another meeting? Can the staff just go ahead
12 and follow the Legislature's request?

13 MR. HEATH: I think we'd have to, frankly, get
14 back to you on that, Mr. Chairman, to really
15 understand, I think, what the Legislature's after and
16 if, in fact, it requires an actual report from the
17 Board itself. And I would like to take the report
18 back to the Board for its adoption. I don't think
19 it's going to authorize us at this point to have the
20 staff just produce a report and send it forward.

21 We could make -- have this perhaps dealt
22 with --

23 CHAIRMAN KAHN: Well, let me --

24 MR. HEATH: To report back to the Board. I'll
25 have to, frankly, get back to you as to how extensive

1 this is going to be.

2 CHAIRMAN KAHN: Well, let's just -- the one
3 thing I want to be clear is that if the Legislature
4 does want action by the EOB, I don't want to delay
5 it; I want to respond swiftly. So we should talk
6 about that once you see what the Legislature
7 does.

8 MR. HEATH: I agree with that, sir. We'll get
9 back to you on that with a report.

10 The next item we have is a resolution -- or
11 a -- a summary which is now in your document on the
12 four resolutions, the status of those and what has
13 occurred since the Board's August 1st meeting.

14 In short, the California ISO as a governing
15 board has taken action on the price cap and has
16 reduced that price cap in their markets to \$250.

17 The second resolution that the Board adopted
18 on the 1st requested the Federal Energy Regulatory --
19 or requested the ISO to request the Federal
20 Regulatory Commission an extension of its
21 price-capping authority. As of to date, I do not
22 believe that they have made that filing with the
23 FERC. That is subject to, of course, a check from
24 Mr. Robinson on that. I believe that that matter for
25 that extension may be up on their Board meeting

1 agenda for next week. I'll authorize their
2 management to move forward with that proposal for an
3 extension.

4 CHAIRMAN KAHN: Mr. Robinson, can you shed
5 some light on that?

6 MR. ROBINSON: Yes. That resolution is up for
7 consideration by the ISO Board next week.

8 CHAIRMAN KAHN: What day is that meeting?

9 MR. ROBINSON: Thursday, the 6th.

10 CHAIRMAN KAHN: Well, when does your authority
11 expire?

12 MR. ROBINSON: November 15th.

13 CHAIRMAN KAHN: Okay.

14 MR. HEATH: The third resolution,
15 Mr. Chairman --

16 CHAIRMAN KAHN: I'm sorry, back up one second.

17 Has there been a meeting of the ISO since our
18 resolution? I think there was one meeting.

19 MR. ROBINSON: There was a telephone meeting
20 of the Board last week to consider an emergency
21 meeting.

22 CHAIRMAN KAHN: Fair enough. Was this issue
23 taken up by the ISO since this resolution has been
24 passed?

25 MR. ROBINSON: ISO staff has been working

1 diligently on this matter since the resolution and,
2 indeed, before the resolution was passed. The Board
3 has not yet considered this matter.

4 CHAIRMAN KAHN: So they haven't turned to
5 staff?

6 MR. ROBINSON: They have not.

7 CHAIRMAN KAHN: Okay.

8 MR. WILLISON: Is it fair to ask what the
9 staff is going to recommend?

10 MR. ROBINSON: The staff is going to recommend
11 that the cap be extended.

12 MR. WILLISON: Thank you.

13 MR. ROBINSON: The price cap has already been
14 extended.

15 CHAIRMAN KAHN: Mr. Heath?

16 MR. HEATH: Thank you, Mr. Chairman.

17 The next item, the third resolution was --

18 CHAIRMAN KAHN: By the way, Mr. Heath, I think
19 that between meetings, as soon as that action is
20 taken or not taken, I know we would like to be
21 informed and I think the governor's office also would
22 like to be informed.

23 MR. HEATH: We will make sure that happens.

24 CHAIRMAN KAHN: Okay.

25 MR. HEATH: Item number -- or the third

1 resolution was also to urge the California Power
2 Exchange to request FERC to authorize the CalPX to
3 impose a cap for the lowest reasonable level and
4 to make such a request at the earliest possible
5 opportunity. The CalPX governing board did take up
6 that action, I believe, on August 22nd. They
7 approved that item for their cap being at \$350 a
8 megawatt hour in its day-ahead and day of markets,
9 and I believe they have made such a filing to the
10 FERC to that effect. And I'm seeing Mr. Sladoje
11 nodding his head in the affirmative on that.

12 The fourth resolution is a resolution that was
13 directed by this Board to its staff to lodge with the
14 FERC a request that FERC find that the wholesale
15 markets in California are not workably competitive
16 and to take necessary actions in light of this
17 finding.

18 At this point, I would like to perhaps turn it
19 over to Mr. Saltmarsh, who has made that filing, to
20 explain that filing further for the
21 Members.

22 MR. SALTMARSH: Thank you. And this probably
23 allows me to dispose fairly quickly of the -- both
24 items that are under the Chief Counsel Report.

25 Two documents were provided for you under

1 Tab 4. One of those is a copy of the filing in the
2 form of a complaint that was lodged with the Federal
3 Energy Regulatory Commission earlier this week. This
4 is a complaint that asks the FERC to make the finding
5 as requested in the Board's earlier resolution that
6 the California markets are not workably competitive
7 at this time and to take such necessary action as
8 they may to ensure that prices resulting from the
9 wholesale markets are just and reasonable in all
10 hours.

11 It also requests that the FERC affirmatively
12 direct that the caps that are in place at this time
13 in the ISO markets remain at levels not above their
14 current level during the pendency of whatever FERC's
15 investigation is in order to determine what they need
16 to do to ensure just and reasonable prices.

17 The other item --

18 CHAIRMAN KAHN: Before we move on,
19 Mr. Saltmarsh, could you give us a real quick
20 understanding of what happens next procedurally?

21 MR. SALTMARSH: The Federal Commission has
22 noted our filing, and has posted it for notice. The
23 filing that we made was also served on several
24 service -- existing service lists at the FERC in
25 related proceedings. The FERC will provide an

1 opportunity for interested parties to intervene and
2 to answer our complaint.

3 CHAIRMAN KAHN: How soon will that be?

4 MR. SALTMARSH: It is -- either the 18th or
5 19th of next month is the date for that filing. The
6 Commission will then decide whether they want to
7 either set the matter for hearing or rule on the
8 pleadings that have been submitted. It's most
9 typical in a complaint that FERC will come out with
10 some sort of an order themselves without conducting
11 any kind of a formal hearing initially.

12 What we have requested in our complaint is
13 that as -- in terms of docketing our complaint be
14 consolidated with FERC's own investigation of
15 wholesale markets and with the earlier filed
16 San Diego Gas & Electric complaint in which they
17 allege that there were uncompetitive problems with
18 the wholesale market in California.

19 The FERC is already involved in conducting the
20 staff investigation. And so what I believe is that
21 the FERC will probably consolidate our complaint with
22 those and leave its ultimate ruling until it thinks
23 it's concluded investigations related to each of
24 those matters. It is possible, because we asked them
25 to affirmatively do something during the pendency of

1 it, that they would come out with some kind of an
2 interim ruling that addresses whether or not they're
3 going to direct the interim bid caps while they're --
4 while they're still looking into the overall market
5 circumstance.

6 CHAIRMAN KAHN: And are you working with the
7 PUC on this, too?

8 MR. SALTMARSH: I've been -- I was in
9 consultation with PUC's staff prior to making this
10 filing and informed them we were making the filing.
11 We are working with the PUC staff more generally on
12 this and everything else related to the ongoing
13 investigation of what's going on in the markets.

14 CHAIRMAN KAHN: And the legislative members?

15 MR. SALTMARSH: Certainly with the EOB
16 legislative members and the governor's office.

17 CHAIRMAN KAHN: Okay. I think that -- there
18 will be a great amount of disappointment if we at
19 least are not allowed to make our case fully in this
20 context.

21 Okay. You were about to move to the next
22 item.

23 MR. HEATH: The next item is a document
24 provided for you for your consideration, though
25 probably not warranting significant discussion in

1 this meeting. It is a staff-prepared update on the
2 progress of the proceeding at the Federal Energy
3 Regulatory Commission on determining a Successor
4 Transmission Access Charge methodology for the
5 California grid. As you know, that is currently in a
6 settlement negotiation phase with a large number of
7 parties having issues of concern primarily related to
8 the relative costs and potential cost shifting
9 involved with bringing municipal transmission owners
10 into the California ISO-controlled grid.

11 CHAIRMAN KAHN: There seems to be new reality
12 in terms of the economics of the municipalities -- at
13 least a reality that is different than was expressed
14 the last time we had testimony on this here in terms
15 of the results of the price spikes and the way the
16 money has flowed. Has that new reality been brought
17 to the attention of people who are running the
18 settlement this evening?

19 MR. SALTMARSH: I would say that and even
20 slightly more broadly the current wholesale market
21 chaos in California has been brought clearly to the
22 attention of the settlement judge who is presiding
23 over this. The -- both the considerations of the
24 municipal utilities as to how it affects their
25 interests and also the -- I think the priority of

1 some of both the existing ISO participant
2 transmission owners, and, indeed, to some extent, ISO
3 staff and state staff who are working on this have
4 been diverted a little bit by what's going on in the
5 market pricing as people are trying to figure out how
6 the price events that are going on affect and relate
7 to every other single proceeding that's going on at
8 the FERC right now.

9 CHAIRMAN KAHN: Has the ISO changed its views
10 on this since its filing?

11 MR. SALTMARSH: There have been incremental
12 changes of position. I don't think I would
13 characterize the ISO's sort of general philosophy in
14 terms of a desirable access charge methodology has
15 changed.

16 CHAIRMAN KAHN: Okay.

17 MR. WILLISON: Can I ask a question, Erik?
18 Has the recent market conditions brought the
19 municipals more of one mind, or have they, because of
20 geography or existing transmission capabilities
21 become actually more divergent in their views?

22 MR. SALTMARSH: I think I would say that --
23 yeah, we have -- we have a representative who seems
24 interested in coming forward. But --

25 CHAIRMAN KAHN: Welcome.

1 MR. SALTMARSH: -- as he's coming up, it is my
2 perception that there are municipal entities who are
3 affected in just about every way by what's been going
4 on in the price -- in the wholesale markets with the
5 prices. And what it has done, in my perspective, is
6 made more immediate and urgent whatever people's
7 positions were. But I think you're probably going to
8 hear that some of the issues related to municipals'
9 abilities or restrictions on participating as
10 generation sellers in the markets are in some legal
11 ways delinked from their existence as transmission
12 system operators. So I think a lot of the issues
13 around what the revenue requirements on the
14 transmission systems are have been only indirectly
15 affected by what's going on in pricings.

16 CHAIRMAN KAHN: Would you be kind enough to
17 introduce yourself.

18 MR. BRAUN: Tony Braun (phonetic). I don't
19 know if this is on. Mr. Chairman, is the mike on?

20 CHAIRMAN KAHN: I don't know if the mike is
21 on. Why don't you speak up.

22 MR. BRAUN: I can certainly do so. I prefer
23 it. Thank you.

24 Tony Braun. I am counsel to the California
25 Municipal Utilities Association in the proceeding to

1 which Mr. Saltmarsh refers.

2 I preface my remarks by saying that it is an
3 ongoing settlement discussion and an open docket in
4 FERC. If I'm struggling with some words, I'm
5 probably struggling with the confidentiality
6 requirements of that docket while trying to give you
7 a feel for the issue.

8 A few questions are pending including, I
9 think, the first one on the effect of the market
10 conditions on discussions about municipals joining
11 the ISO. The second was the issue of changes in
12 parties' positions and municipals in a diversified
13 municipal community.

14 We have approximately 25 distribution
15 companies that are municipally owned in California
16 that have varying amounts of transmission. But,
17 however, we have put together and worked hard within
18 the ISO's process and at the FERC proceeding itself
19 to have a united position and a coalition for the
20 purposes of settlement and for the purposes of
21 working through the ISO's stakeholder process. And
22 so we have had and to date we still have a united
23 municipal position on how to resolve these issues.
24 That does not gloss over the fact that there is
25 diversity within the municipal community, to be sure,

1 and different issues address and impact different
2 municipalities in different ways.

3 The market conditions -- I think that's an
4 excellent question, how have the market conditions
5 affected the parties and our parties, our municipal
6 utilities' view of ISO participation. At a minimum,
7 it has certainly introduced an additional element of
8 uncertainty. We are impacted by the ISO's operations
9 and the market practices whether or not we join the
10 ISO. But transferring control of our transmission to
11 the ISO and conforming with the ISO's operational
12 practices and protocols definitely means a change in
13 the way we do business. So there are certain market
14 choices that are inherent in transferring the control
15 of key assets, like transmission lines, to the ISO.
16 And the realities of the market, both the energy
17 market and the ISO's markets that they run, including
18 the Ancillary Service Markets, have introduced -- if
19 there is an increase amount of uncertainty in the
20 prices that our customers would see in the market due
21 to the fact that we have to operate closer to the --
22 to the market protocols in the ISO-administered
23 markets, it definitely introduces an additional
24 degree of uncertainty into the discussions.

25 CHAIRMAN KAHN: Well, hasn't the recent

1 experience also introduced an additional element of
2 money?

3 MR. BRAUN: On both sides. Some of the
4 municipal utilities have -- well, they fall into all
5 different kinds of categories.

6 CHAIRMAN KAHN: Some have done very well.

7 MR. BRAUN: Some of them have generation
8 capacity in excess of their loads. They also have
9 transmission access to markets all over the western
10 United States, and so they are able to sell into the
11 ISO markets. Some are able to simply be available to
12 the ISO in case they have excess capacity in times of
13 emergency, and there's payments in those
14 out-of-market circumstances that accrue. You've also
15 seen in the papers, I believe, the experience of the
16 Sacramento Municipal Utility District where their
17 Rate Stabilization Fund that they've been using to
18 pay down debt has basically been evaporated by this
19 summer's activities. Also, Roseville Electric
20 Utility has not had sufficient resources to meet
21 load, has had to rely on market resources to do so.
22 They have had a tremendous increase in their
23 wholesale price of power to the extent that they have
24 just signed a long-term five-year deal with a power
25 marketer to meet an additional component of their

1 load going forth for the next five years in an
2 attempt to hedge the market volatility.

3 Other folks, the prices to the extent that
4 they have excess resources, whether they are
5 participating in the ISO's markets -- and some are
6 not due to some of the differences in operational
7 protocols and the rules that the ISO demands to
8 participate in their markets, still they may be
9 transacting in other markets, bilateral transactions
10 with other participants. And what happens there is
11 those monies go generally to offset debt that they
12 have accrued. Because even though their resources
13 are running, most of their resources are new and they
14 have a high debt load, and so they have fixed debt
15 payments that they need to make irrespective of what
16 the market prices are. What happens when the market
17 prices go up is it gives them an ability to
18 accelerate repayment of that debt.

19 CHAIRMAN KAHN: Right. And those arguments
20 were quite articulately advanced in the hearings we
21 had here on the subject. And there was some
22 suggestion that somebody should find several hundred
23 million dollars to fill that hole. Sounds to me, it
24 looks to me, based on the pronouncements from some of
25 your clients that that money has been found. The

1 market has showered it upon you. We would just hope
2 that you would take that in consideration in your
3 negotiations.

4 We thank you very much for your participation.

5 MR. BRAUN: Thank you, Mr. Chairman.

6 CHAIRMAN KAHN: You're welcome.

7 MR. Heath?

8 MR. HEATH: Yes. Thank you, Mr. Chairman.

9 I had one item left on my list dealing --
10 before we get to the NCPA issue on 10-minute
11 settlements, and that was, for those who are keeping
12 scorecards these days of who's investigating who and
13 how many are going on, we have right now related to
14 the events in May and June and perhaps in parts of
15 July -- investigations are underway by seven
16 different organizations including the ISO and PX
17 itself in terms of the price run-ups. We will be
18 hearing a report on those later on in today's
19 hearing. I just want to bring to your attention that
20 as it currently stands, we -- the Oversight Board,
21 Public Utility Commission under two separate
22 proceedings, the Federal Energy Regulatory
23 Commission, the California Attorney General,
24 California State Auditor and, as I mentioned, the ISO
25 and PX themselves are all conducting various

1 investigations related to the price run-ups this last
2 spring and summer -- early summer.

3 CHAIRMAN KAHN: Mr. Heath?

4 MR. HEATH: Yes, sir.

5 CHAIRMAN KAHN: Apropos of that, I think it's
6 very important that in our role in the state that we
7 keep track of the information that's being developed
8 in those various investigations and that
9 Mr. Saltmarsh uses his good offices to be sure that
10 the results and the information is in some fashion
11 all brought to the attention of FERC. And I know
12 that he's doing that. I realize that's creating some
13 burden for you to track a lot of things that are
14 going on, but I think that the Administration's view
15 is that we ought to know what's going on and that we
16 ought to be sure, especially in light of our recent
17 filing that that information gets brought to the
18 attention of FERC. Is that doable?

19 MR. HEATH: That is doable. And I'm getting a
20 nod from Mr. Saltmarsh that that's doable.

21 CHAIRMAN KAHN: Okay.

22 MR. HEATH: Last thing on that is that at this
23 time staff is projecting to have its -- part of its
24 investigation concluded no later than the 1st of
25 November. And we'll be working with the Board on

1 that in terms of any preliminary findings that we
2 have in that regard.

3 The last item, what we deferred for a few
4 moments, is the issue of the 10-minute settlement.
5 And I believe a representative from NCPA was coming
6 forward to address that issue to the Board.

7 CHAIRMAN KAHN: Welcome to the ISO now.

8 MR. ROBINSON: Yes. Thank you.

9 CHAIRMAN KAHN: Would you be kind enough to
10 introduce yourself.

11 And maybe we can get the mikes up and running
12 here.

13 Why don't you go ahead the best you can.
14 We're having technical difficulties. Go ahead.

15 MR. BRECKON: Chairman Kahn, Mr. Willison,
16 thank you.

17 I'm the Information Systems Manager at
18 Northern California Power Agency. My name is Tom
19 Breckon. I've been in that position for almost 20
20 years. I've been involved with the development of
21 computer software and software that communicates with
22 the ISO since January of 1997. I was the technical
23 lead for the Scheduling Coordinator Users Group all
24 during market start-up, at technical subgroup between
25 the ISO, the PX and the scheduling coordinators. And

1 after-market start-up, I've been one of the charter
2 members of the ISO's Technical Standards Working
3 Group.

4 The Technical Standards Working Group was
5 formed as a technical forum between scheduling
6 coordinators and the ISO to disseminate information
7 and originally was hoped would be involved in writing
8 and putting out standards. To date, the phrenetic
9 activity in the marketplace has not allowed time to
10 put out any standards, but it has been a useful group
11 for disseminating information.

12 There was, however, one issue that we
13 discussed in that group and thought we had agreement
14 on with the ISO, and that's the recognition that
15 scheduling coordinators need a period of time to test
16 their software so that it works properly with the
17 software of the ISO and then a period of time for
18 vendors in the marketplace to package up that
19 software, get it distributed to their scheduling
20 coordinator customers, get it installed, get it
21 tested and so on.

22 Before I proceed -- and I'm a little
23 disorganized because I didn't know until an hour ago
24 that I'd be here, but maybe that might be an
25 indication of what's happening in IT shops throughout

1 the state; we're all scrambling, trying to get things
2 done on a moment's notice.

3 NCPA, of course, is not in the ISO today;
4 although, we have been preparing, and my role there
5 has been to prepare all along to be ready to be in
6 the ISO, and that's why we're developing software,
7 that's why we're acting as a scheduling coordinator.
8 We're providing that service to others, and some of
9 our units are being scheduled directly with the ISO
10 today -- although, not all, not a majority because of
11 problems with the interconnection agreement with PG&E
12 and such.

13 But nevertheless, we thought all along that
14 market simulations with the ISO, which is the process
15 that you go through to test your software with the
16 ISO to make sure their software works, to make sure
17 our software works, to make sure it all communicates
18 with each other, that that was to be a time when we
19 both got to test -- the ISO and scheduling
20 coordinators. What's happened with 10-minute
21 settlements is that the first market simulation
22 didn't work very well. A second market simulation
23 was scheduled; in our opinion, that simulation didn't
24 work very well either for a whole variety of reasons.
25 In the case of NCPA, we did not receive from the ISO

1 any usable settlement statements until just a little
2 over a week ago -- 10-minute test statements that we
3 could even begin our testing.

4 In my opinion, this is not a proper market
5 simulation where the ISO goes day to day solving
6 their problems, and when their problems are fixed and
7 finished they then announce, well, the test is a
8 success without regard to the fact that scheduling
9 coordinators on on the tail end of that process. We
10 need time to test; we need time to put proper systems
11 in place. A week for us -- this is an incredibly
12 complex settlement process, 10-minute settlements.
13 And it's not just settlements down the road, because
14 there's a 40- to 60-day lag time before you have to
15 run settlement statements. In order to be ready to
16 do 10-minute settlements, you have to record all the
17 information properly in your settlement -- in your
18 system at the time you do scheduling, which is
19 tomorrow. So while we've prepared as best we can --
20 and we certainly hope that our software is ready --
21 we don't know. And I think there's many shops in the
22 state that don't know because we haven't had the time
23 to work through all of the testing that's required.

24 The conference call that occurred with the ISO
25 last Friday, the ISO asked market participants who

1 was ready for 10-minute settlements? The answer was
2 none. Nobody spoke up. Despite that, the ISO staff
3 said that they were recommending to their management
4 that the ISO proceed on September 1st. So here we
5 are, trying to scramble, trying to throw together
6 software and who knows if it will work. We don't
7 know.

8 I really think -- there's three stages to
9 testing software. The first, the programmer tests
10 his program until it works. Then the vendor tests
11 all the programs working together -- it's an
12 integration test. Finally, the customer -- the ISO,
13 in this case, tests their software with the
14 marketplace to see that it all works. In my opinion,
15 what the ISO just completed was the second level of
16 testing because they found lots of problems -- they
17 fixed them along the way, so they say. They finally
18 got us data that we could work with, but much too
19 late. But we're now ready for market simulation. We
20 haven't had one yet. We've had a beta test, if you
21 will, but we haven't had a market simulation. And
22 here we are starting a marketplace that's a
23 multi-billion market -- dollar marketplace, and we
24 frankly don't know if our software's going to work or
25 not. We hope it will. Perhaps it will all work, and

1 this won't be an issue. But it just doesn't seem to
2 me the best -- the right way to proceed.

3 MR. WILLISON: Do you have the same vendors,
4 both parties?

5 MR. BRECKON: No, sir, we don't. There's many
6 vendors in the marketplace.

7 MR. WILLISON: That are working on this issue.

8 MR. BRECKON: Yes. And that's one of the
9 problems. We can read specs; we can prepare as best
10 we can, but we cannot test software to schedule and
11 to settle until we get the results from what the ISO
12 software produces. And that for us, the NCPA, wasn't
13 ready until a little over a week ago.

14 CHAIRMAN KAHN: I have two questions. First of
15 all, what would you like to happen?

16 MR. BRECKON: What I'd like to happen is for
17 the delay to occur. We asked that in our letter. We
18 asked for a delay until November 1st.

19 I might mention that BPA, who was one of the
20 participants in the market simulation, sent a letter
21 to Mr. Winter that had 11 signatories on it, 11
22 companies who were probably the majority of the
23 companies participating in the market simulation, all
24 asked for a delay to give the companies time to test
25 their software, to feel comfortable that everything

1 was ready to go.

2 CHAIRMAN KAHN: My second question is what
3 will the consequence be if your software does not
4 work?

5 MR. BRECKON: Well, if I may, the first
6 question should be what's the consequence if the ISO
7 software doesn't work? That would be terrible.
8 Because even when we get preliminary settlement
9 statements, now because of the changes to the ISO's
10 invoicing process -- money changes hands based on
11 preliminary settlement statements. If the ISO
12 software works, then the impact to individual
13 companies is -- and I'll tell you what the impact is
14 specifically at NCPA; there will be a period of four
15 or five weeks yet where our software won't be ready.
16 We'll schedule somehow. We won't know for sure if
17 we're recording the data in a way that will
18 facilitate 10-minute schedule -- settlements.

19 When we get the ISO settlement statements, if
20 they're right or wrong, we won't know because our
21 software won't be ready to confirm and verify their
22 charges. We'll be flying blind.

23 CHAIRMAN KAHN: Okay. Anything further?

24 MR. WILLISON: No. I'd like to hear from the
25 ISO.

1 CHAIRMAN KAHN: So would I.

2 MR. BRECKON: Thank you.

3 CHAIRMAN KAHN: Thank you very much.

4 MR. FLUCKIGER: Good morning, Chairman Kahn
5 and Mr. Willison. I'm Kellan Fluckiger with the
6 California Independent System Operator, and I'd like
7 to address the issue of the 10-minute -- proposed
8 10-minute market.

9 CHAIRMAN KAHN: Kellan, perhaps you could --
10 there's a couple of things that I'm particularly
11 interested in.

12 MR. FLUCKIGER: Okay.

13 CHAIRMAN KAHN: Why do you want to do this?
14 Why do you want to do this now? And what will be the
15 disadvantage of delay?

16 MR. FLUCKIGER: Okay. The 10-minute market
17 is -- the original market design was a 5-minute
18 market. It was designed when the ISO went
19 operational. That was delayed, and we operated with
20 hourly markets until now. The consequences of
21 operating without the 10-minute market we've
22 estimated to be in the range of additional costs for
23 Ancillary Services and the balance of energy
24 increases that are on the order of 150 to
25 \$200 million annually. That, we believe, is the

1 amount of money that is spent, that does not need to
2 be spent because we are operating with an hourly
3 market as opposed to the subhourly markets that were
4 originally designed.

5 In addition, the hourly markets that we have
6 cause market participants to engage in unobstructed
7 deviations, which are simply making generators move
8 following prices without being instructed by the ISO.
9 This makes it exceedingly difficult to operate the
10 control area and makes us buy a whole lot more
11 regulation for generators that we have control over
12 and spend a lot more money than we need.

13 So the primary purpose of a 10-minute market
14 is to control the electricity system better because
15 it changes the pricing structure, reduces the time
16 interval, and it puts significant incentives in place
17 for people to follow directions as opposed to simply
18 operate units at their own discretion.

19 So we believe that there will be two major
20 improvements with the implementation of a 10-minute
21 market. One, unobstructed deviations will disappear;
22 and, two, consumers of the state of California will
23 save significant amounts of money in the Ancillary
24 Service and in balanced energy markets. So that's
25 the reason we're doing the 10-minute markets.

1 The second question, why now, we have one
2 month of summer left. If we look at the cost-saving
3 estimates that we have, the estimate that I have if
4 September is warm --

5 CHAIRMAN KAHN: I'm sorry.

6 MR. FLUCKIGER: I'm sorry. That's fine.

7 CHAIRMAN KAHN: Okay. Go ahead.

8 MR. FLUCKIGER: If we look at the cost
9 estimates that we have for an annual amount of money
10 and we look at the fact that September is predicted
11 with a long-range weather forecast to be a warm
12 September, I estimate that as much as \$30 million of
13 that 150 to \$200 million could be at issue here for
14 the month of September.

15 It's interesting to note that we had
16 additionally slated the beginning of 10-minute
17 markets for June the 1st in order to capture the
18 efficiencies for summer. We then delayed it from our
19 participants' requests, similar to those that you
20 heard today, until October 1st and then implemented
21 an additional 30-day delay resulting in a total of a
22 90-day delay for most of the summer to September
23 the 1st.

24 I wanted to just mention the ISO certainly
25 acknowledges Mr. Breckon and NCPA's contribution to

1 all of our software efforts from the beginning and
2 from start-up and the value that he's brought to that
3 process, and in no way or anything that I say today
4 to subtract from the accomplishments of NCPA and
5 others in helping all of the software, including this
6 10-minute process to be brought forward.

7 The ISO believes that it has done absolutely
8 all necessary due diligence, tested the software,
9 provided significant and sufficient settlement data
10 to market participants to test their systems, has
11 conducted numerous training classes -- I have dates
12 and times of all of those kinds of things, if they're
13 of interest -- a number of market simulations, market
14 simulation days, the amount of data that has been
15 available -- I have all of that information if you
16 need any of that. Bottom line of that all,
17 Chairman Kahn, is that we believe that the ISO
18 software is completely ready; that we have addressed
19 all of the necessary issues. We stand -- we have
20 worked with market participants and stand ready to
21 continue to do that. We believe that they have the
22 information. We have contacted the largest
23 participant in the market, the Power Exchange, and
24 they have indicated that they are ready and they're
25 able to implement this tomorrow. And we believe that

1 for the financial reasons as well as the system
2 operational and control reasons that it is important
3 to not further delay the implementation of this
4 market.

5 CHAIRMAN KAHN: Question?

6 MR. WILLISON: How do you react to the balance
7 of what your counterparts say that they're not ready?
8 Do you think that they need more testing? Is that
9 the feedback that you're getting? They need a period
10 of time to run this now with both softwares, I guess,
11 working together?

12 MR. FLUCKIGER: I guess I would respond to it
13 this way: You can always test something more, and we
14 have absolutely found some very small -- in the
15 initial phases, some larger, but as we progressed
16 toward implementation, some progressively very, very
17 small software glitches, for better words, and those
18 have all been taken care of. We believe that we're
19 ready. There is a delay. The first settlement
20 statements, as you know, come out 45 days after
21 operation. So there is some delay of time there and
22 certainly opportunity for things to be addressed if
23 they -- if they come up. But we believe that we're
24 prepared now with no glitches to go ahead.

25 In terms of what the software does that the

1 market participants have, it's basically verification
2 software so that they can check our bills. In other
3 words, they schedule with it and they use that so
4 that they can check to see whether or not the bill
5 that we've sent them or the money that we pay them is
6 correct. And so it's a redundancy primarily to make
7 sure that they understand and verify the transaction
8 dollars that they place between the ISO and the
9 scheduling coordinator.

10 MR. WILLISON: That was my next question is
11 what is the risk that you see if the two systems
12 didn't talk to each other right away during the
13 initial period of time?

14 MR. FLUCKIGER: I believe that, first of all,
15 the risk is small. And, second of all, I believe
16 that with the delay in settlement statements, if
17 the -- if certain market participants identified
18 glitches in their software, there will be time for
19 them to work with their vendors and get those worked
20 out. And then do we have all of this data available
21 that they can still query and use to test their
22 systems between now and the first live settlement
23 statements, which will be 45 days after
24 September the 1st.

25 MR. WILLISON: So it's not an issue that gets

1 directly to the customer -- I'd be concerned anything
2 that would have to do with -- with looking like poor
3 management on behalf the ISO again, given this
4 question of confidence that the general public has
5 anyway, ensuring that we avoid any risk there.

6 MR. FLUCKIGER: I share that concern. And the
7 balance here is, one, there's a delay of 45 days
8 before settlement statements go out. Two, there's a
9 lot of money at issue here with the implementation of
10 the 10-minute markets in terms of savings to the
11 customer. And so can you do more testing and be then
12 between 99 and 100 percent sure of perfection in all
13 of the software systems? Of course. We just don't
14 think that that's an appropriate balance.

15 CHAIRMAN KAHN: Mr. Heath, does the staff have
16 a recommendation?

17 MR. HEATH: Actually, I was hoping we would
18 also hear from Mr. Sladoje, who's actually the
19 largest scheduling coordinator, and see where his
20 systems are and see if they are ready to go forward
21 with it. And I'd also like to know where the Power
22 Exchange is in terms of its settlement, and are they
23 ready on the settlement side, also.

24 CHAIRMAN KAHN: Mr. Sladoje, if you're
25 prepared, fine. If you're not, don't mean to put you

1 on the spot.

2 MR. SLADOJE: No, no. Thank you,
3 Mr. Chairman.

4 We made a commitment some time ago that we
5 would be ready September the 1st, and we're sticking
6 with that commitment. I want you to understand what
7 this means. We don't have everything in place right
8 now. Everything has not been tested from beginning
9 to end. But as Kellan has pointed out, we won't be
10 reacting to the September 1st date until mid-October.
11 And we are confident that everything will be in place
12 at that time.

13 We've mapped out alternative procedures in the
14 event that there are some issues that might arise.
15 We've spent some money developing some alternative
16 paths. And -- so -- and, frankly, the fact that it's
17 not 100 percent in place is not new in this
18 marketplace. We started March 31st of '98 without
19 having a complete settlement system in place. So
20 we're confident that we've got things in place and in
21 motion so we'll be ready to go on -- and we're
22 willing to live up to that September 1st
23 commitment.

24 CHAIRMAN KAHN: Mr. Heath.

25 MR. HEATH: Thank you, Mr. Chairman, and

1 Member.

2 At this point we would like to have the ISO
3 express in no uncertain terms its confidence on
4 that -- that we will not have any adverse affect
5 related to the viability of the system, in
6 particularly with the generators. Associated with
7 that, we would like to have within the next -- the
8 first 30 days of this, perhaps a report back to the
9 Board on that to see -- making sure that -- that
10 everything went as predicted on the reliability side
11 with a follow-up after the first round of settlements
12 and make sure that the settlements are occurring in a
13 timely way. If they express that confidence -- and
14 it was an issue that was, in fact, the Oversight
15 Board raised in its, I believe, May 19th, 2000,
16 filing on this matter before the FERC, we would like
17 to be assured that the system is reliable. And if
18 they make those overtures today, then they'll report
19 back to the Board within 30 days.

20 CHAIRMAN KAHN: Mr. Fluckiger, I take it from
21 your statements that you make that representation.

22 MR. FLUCKIGER: That's correct. In fact, I
23 believe that the implementation of the 10-minute
24 markets will improve system reliability.

25 CHAIRMAN KAHN: Okay. Fine. Then I take it

1 there's no further action -- let me just give you a
2 reaction from the Chair, and that is we have two
3 different predictions here. We have one that's a
4 little dire and one that has some confidence. And
5 part of our function in oversight is not to interfere
6 with your judgments, but is to oversee the accuracy
7 of your predictions. So we look forward to doing
8 that. For my money, I hope you're right and it works
9 out fine. But in any event, Mr. Heath will be
10 coordinating with you. And if for some reason
11 predictions aren't as you hoped they'd be, we'll ask
12 you to explain it to us so we can let the
13 Administration and the Legislature understand how
14 well this is working.

15 Thank you very much for coming. It leaves us
16 a little more prepared.

17 Mr. Breckon, thank you, also, very much. We
18 appreciate your input. I guess we're hoping that you
19 won't be right in your dire predictions, but we look
20 forward to working with you and learning how it does
21 from now. And if there's anything that the Board can
22 do while you're going through this experience, you
23 should please contact staff, and we'll be happy to
24 work with you.

25 Mr. Heath, next?

1 MR. HEATH: Yes. That completes the
2 Management Report. Next would be the Chief Counsel's
3 Report. I don't know if Mr. Saltmarsh had anything
4 to add to his remarks.

5 MR. SALTMARSH: No, Mr. Chairman. With a
6 fairly full agenda, I think it the two items that
7 would be covered have already been addressed --
8 unless you have further questions.

9 CHAIRMAN KAHN: Okay. So we'll move to ISO
10 and PX governance matters. It's something that seems
11 never to escape our agenda.

12 Mr. Heath, how do we proceed?

13 MR. HEATH: There are -- the agenda is sort of
14 divided in two different actions: One, our
15 approval -- our consideration, I should say, of bylaw
16 amendments. I would suggest perhaps we take up the
17 bylaw amendments first and then move into the issue
18 of appointments. I believe, also, that it may be
19 desirable on the part of the Board to go into closed
20 session to discuss the appointment matters.

21 CHAIRMAN KAHN: Okay. Let's take up the
22 amendments, then, if it's okay with you,
23 Mr. Willison.

24 MR. WILLISON: That's great.

25 CHAIRMAN KAHN: Let's do.

1 MR. HEATH: Very good. Thank you,
2 Mr. Chairman, Member.

3 I'd like to ask Ms. Catherine George, EOB
4 Staff Counsel -- she's coming forward. She'll be
5 presenting these items on behalf of the staff.
6 Mr. Saltmarsh will also be participating in that.
7 Also, I believe, Mr. Robinson is here representing
8 ISO on this matter and Mr. Rasmussen, also, from the
9 California Power Exchange. It might be just more
10 efficient to have all three of them at the table for
11 this item.

12 CHAIRMAN KAHN: Welcome, Mr. Rasmussen. Every
13 time that you come up here, it seems that you get cut
14 off. Hopefully, we'll be able to finish our business
15 today. Thanks for your patience.

16 Welcome, Mr. Robinson.

17 MR. ROBINSON: Thank you.

18 CHAIRMAN KAHN: Ms. George, do you want to
19 lead this discussion?

20 MS. GEORGE: Good morning, Chairman Kahn and
21 Mr. Willison.

22 We have, I think, five items that are
23 unrelated to -- or relatively unrelated to the
24 nominations: 5-A through D and 5-F.

25 5-A being the first item, this one is an

1 informational item. It concerns whether or not the
2 Board should establish a preferred policy regarding
3 dual membership or overlapping membership on the
4 governing boards on the CalPX and the CalISO. This
5 item responds to a request that the Board made at its
6 March 2nd meeting, that we provide the Board with
7 some history on this issue. For the reasons stated
8 in your materials, we don't recommend that a policy
9 be established at this time, but that the Board take
10 into account the prospect of overlapping membership
11 when it considers nominations of individual
12 candidates. So with that, if you concur with staff's
13 recommendation, then no action would be necessary on
14 this item.

15 CHAIRMAN KAHN: Mr. Willison?

16 MR. WILLISON: Great. That's not a motion.
17 We just (inaudible).

18 CHAIRMAN KAHN: Right. Do you have any
19 comment you want to make on it?

20 MR. WILLISON: No. I think, as we'll see,
21 there's a lot of issues that it's going to be --
22 excuse me. I think there's going to be a lot of
23 issues related to Board governance that a better part
24 of judgment will be to not make any decisions today.
25 This is one of them.

1 MS. GEORGE: It's always a possibility that
2 you could establish a policy at a later time if you
3 wish.

4 MR. WILLISON: Correct.

5 CHAIRMAN KAHN: Okay. That's okay with me.
6 Let's go to Item 5-B.

7 MS. GEORGE: Item 5-B addresses three
8 outstanding amendments to the California ISO's
9 corporate bylaws. As your material reflects, staff
10 recommends that the Board reject each of these three
11 amendments and request that the ISO's Board of
12 Governors make further modifications to their bylaws
13 and bring those amendments before you at a later
14 meeting for your consideration. I'd be happy to go
15 into the details of three amendments, if you'd like.
16 They're laid out in your materials, so I'll leave
17 that up to you.

18 CHAIRMAN KAHN: I read them. I'm curious,
19 have you discussed these modifications with the ISO?

20 MS. GEORGE: I have. Not with Mr. Robinson,
21 but with Mr. Jacobs, who has been handling these
22 matters largely for the ISO. And my understanding
23 from my last conversation with him was that he did
24 not have concerns about our rejection of these. He
25 informed me that what they would then do, with some

1 clear guidance from our Board, is go back to their
2 Board and take these up as a lump sum and then bring
3 them forward to us at a later time.

4 CHAIRMAN KAHN: Is that okay with you,
5 Mr. Robinson?

6 MR. ROBINSON: Yes, it is.

7 CHAIRMAN KAHN: Okay. Mr. Willison, I'll
8 entertain discussion or motion as to 5-B.

9 MR. WILLISON: Well, I'll just -- first of
10 all, I'll move the recommendations to reject the
11 proposed three amendments at 5-B.

12 CHAIRMAN KAHN: Pursuant to the resolution
13 modifying that item...

14 MR. WILLISON: I'm sorry. I've got things --
15 okay. Okay. So I will move that the Board does
16 reject the ISO's proposed amendments to the three
17 articles cited, and, second of all, that we recommend
18 to the ISO that it modify the language of Article 3,
19 Section 6 as has been communicated, to modify the
20 language of Article 3, Section 7, and provide the EOB
21 a role in approving the removal of any state
22 confirmed or state confirmed governor pursuant to
23 this action, and then modify the language of
24 Article 9, Section 3.3 to pattern the language of the
25 California PUC Code and submit the amendment to our

1 Board for subsequent approval.

2 CHAIRMAN KAHN: And I'll second that motion.

3 Any discussion?

4 MR. WILLISON: The only comment I was going to
5 make is my understanding is that by not approving
6 these at this time does not inhibit the ISO from
7 conducting its business.

8 MR. ROBINSON: That's correct.

9 CHAIRMAN KAHN: All in favor?

10 Aye.

11 MR. WILLISON: Aye.

12 CHAIRMAN KAHN: That motion passes two to
13 nothing.

14 I understand the court reporter needs a break?
15 No?

16 THE REPORTER: No, thank you.

17 MR. SALTMARSH: It was indicated that this was
18 the time window in which we were planning to give the
19 court reporter a break.

20 CHAIRMAN KAHN: If you can last a few more
21 minutes -- I want to go through this (inaudible), and
22 then we'll take a break -- a long one -- while we
23 consider the nominations. But if it becomes
24 burdensome, just throw something at us.

25 Going to 5-C.

1 MS. GEORGE: Thank you.

2 Item 5-C pertains to numerous amendments to
3 the California Power Exchange's corporate bylaws.
4 With the exception of the first amendment, which is
5 identified as CalPX No. 1 on -- it's listed on page 2
6 of your memo, we -- the staff recommends that the
7 Board approve all of these amendments. With respect
8 to CalPX No. 1, we don't make a recommendation to
9 you, but we do -- well, we do recommend that you
10 consider whether the revisions to the eligibility
11 criteria that that amendment would affect meet with
12 your comfort level. They would be slightly more
13 restrictive as to what entities could register to
14 participate in this class. I don't know if you wish
15 me to go through any of these in detail or if you
16 have any questions about any of these particular
17 amendments.

18 CHAIRMAN KAHN: I'm familiar with them myself,
19 but the one question I have, your report indicated
20 that there wouldn't be a substantial effect of the
21 amendment that you were making a recommendation on.
22 For all practical purposes, the situation would be
23 the same; is that right?

24 MS. GEORGE: Well, there's a potential that
25 there could be an entity that has not participated in

1 both environmental and energy-related matters and may
2 have participated in one or the other, and that
3 entity under this proposed amendment would not be
4 able to register in this class.

5 CHAIRMAN KAHN: Isn't this self-defined? I
6 mean who's going to stand up and say, "I was
7 environmental only, but energy didn't matter"?

8 MS. GEORGE: Well, Mr. Rasmussen can correct
9 me if I'm wrong, but I think that the -- there's a
10 requirement that the person -- that the entity have
11 participated actively in a proceeding that was
12 either -- or, actually, under the amendment would be
13 both environmental and energy related.

14 CHAIRMAN KAHN: Mr. Rasmussen, do you want to
15 comment on that?

16 MR. RASMUSSEN: I think I can shed some light
17 on it.

18 We asked registrants to self-verify their
19 eligibility. If there were a contest around what is
20 stated in the Eligibility Statement, I suppose it
21 would be ultimately to our Board to determine
22 eligibility. We have, as I indicated, not had that
23 occasion to do that.

24 CHAIRMAN KAHN: Is there any objection to
25 this?

1 MR. RASMUSSEN: No. It was unanimously
2 supported by the registrants in the public interest
3 group class at the time we had a teleconference vote
4 on the matter. And it was brought forward through
5 that process under our bylaws. So the class itself
6 would like to see this.

7 CHAIRMAN KAHN: Okay. Mr. Willison, do you
8 have any questions about this or any other amendment?

9 MR. WILLISON: No.

10 CHAIRMAN KAHN: I'll entertain a motion.

11 MR. WILLISON: I move that our Board approve
12 the amendments to the California Power Exchange
13 corporate bylaws identified as CalPX 1 through 12.

14 CHAIRMAN KAHN: I second that.

15 Any discussion?

16 All in favor?

17 Aye.

18 MR. WILLISON: Aye.

19 CHAIRMAN KAHN: That passes two to nothing.

20 Okay. Does that conclude the PX except for
21 the --

22 MS. GEORGE: It concludes the PX with regard
23 to amendments to the bylaws. There is the
24 chairperson appointment issue.

25 CHAIRMAN KAHN: Right. We'll get there.

1 Congratulations, Mr. Rasmussen, you finally
2 got it all done.

3 MR. RASMUSSEN: Thank you, Mr. Chair.

4 CHAIRMAN KAHN: All right. That brings us,
5 then, to 5-D.

6 MS. GEORGE: Item 5-D is a Status Report and,
7 again, no specific action is required. This item is
8 is intended to provide you with the status as to the
9 CalPX's bylaw, amendments regarding the chairperson
10 appointment authority. And a letter is attached to
11 the memorandum which is in your Board materials from
12 Mr. Rasmussen explaining why the CalPX's proposed
13 amendment that was before you -- it's not before you
14 at this meeting; it's been deferred at past
15 meetings -- and also contains the proposal that the
16 PX is seeking your guidance on. If I may defer to
17 Mr. Rasmussen if you'd like him to elaborate on that.

18 CHAIRMAN KAHN: Before you do that, do you
19 have a recommendation on the proposal?

20 MS. GEORGE: I don't have a specific
21 recommendation on that proposal.

22 CHAIRMAN KAHN: Okay. I have to confess, it
23 looked okay to me.

24 MR. RASMUSSEN: Well, from my point of view,
25 the consensus of the Board is that PX would like to

1 put this behind us and move forward. It's been
2 pending for some time. As you know, the FERC has
3 approved the current bylaw text in the necessary
4 action. If this is acceptable to the Oversight Board
5 within -- once again, we'd go back to FERC and
6 indicate that we would like to revise this particular
7 appointment process. The guidance we seek is just
8 that, for some direction from the Board so we can
9 break the impasse, if there is one, and move this
10 thing and get it done.

11 CHAIRMAN KAHN: Mr. Willison, do you have any
12 questions or comments?

13 MR. WILLISON: No. No, I had the same
14 reaction that it seemed like it was a plausible,
15 rational approach. So I guess I would just maybe
16 ask Mr. Heath if he has any other comments or
17 concerns.

18 MR. HEATH: I have no further comments or
19 concerns. And I think that what I'm hearing from the
20 Board that the proposal is acceptable, we can support
21 that.

22 CHAIRMAN KAHN: I think you got what you want,
23 Mr. Rasmussen.

24 MR. RASMUSSEN: Thanks again.

25 MR. WILLISON: It's not officially before us

1 at this time, but it could be or does it make
2 sense --

3 MR. HEATH: I think you're providing some
4 guidance at this point, and I think that -- I believe
5 at some point we'll have to come back to the Board
6 for approval.

7 Is that correct?

8 MR. RASMUSSEN: Next week is our Board
9 meeting. I'll make the report at the Board meeting,
10 and I'll indicate that the Oversight Board has
11 indicated that this will be a favorable resolution --
12 or the proposal would be acceptable to the Oversight
13 Board. We are able to take action on the bylaws
14 amendment at the next meeting because we have the
15 requisite notice of bylaw amendment. As I said, then
16 we would go forward with filing this here with the
17 Oversight Board for approval.

18 CHAIRMAN KAHN: Okay. Are there any other
19 non-nominee issues?

20 MS. GEORGE: There's one more matter for your
21 consideration, and that's Item 5-F. It got stuck in
22 between the nominations for the CalPX and the CalISO.
23 It concerns the appointment of Mr. John Geesman as
24 chairperson of the California Power Exchange. Would
25 you like to take that up at this time?

1 CHAIRMAN KAHN: Isn't that something we should
2 probably have an executive session to discuss that
3 along with the others?

4 Mr. Heath?

5 MR. HEATH: Yes, that would be an appointment
6 matter that we probably should take up under
7 executive session.

8 CHAIRMAN KAHN: Okay. Anything else,
9 Ms. George?

10 MS. GEORGE: No.

11 CHAIRMAN KAHN: Thank you, Mr. Robinson,
12 Mr. Rasmussen.

13 MR. ROBINSON: Thank you.

14 CHAIRMAN KAHN: We will now take a break and
15 go into executive session. I would anticipate that
16 it would be at least 20 minutes. And so we will
17 adjourn and then convene in executive session. And
18 we will try and reconvene at 11:30, but I can't
19 promise.

20 (Brief recess.)

21 CHAIRMAN KAHN: I think we'll reconvene.

22 Ms. George?

23 MS. GEORGE: I'd like to take up Item 5-F now
24 which concerns the possible appointment of Mr. John
25 Geesman as chairperson of the California Power

1 Exchange. As you're aware, he's been acting as chair
2 since March 1999 pending confirmation by the
3 Oversight Board. Action to appoint him at this time
4 and to formalize the status of the chairperson and
5 serve to ratify the action he has taken over the past
6 year and a half.

7 CHAIRMAN KAHN: Mr. Willison, if you will.

8 MR. WILLISON: Yes. Thank you. We'll move
9 that the Board approve the appointment of Mr. Geesman
10 as the Power Exchange chairperson.

11 CHAIRMAN KAHN: Second.

12 All in favor.

13 Aye.

14 MR. WILLISON: Aye.

15 CHAIRMAN KAHN: Mr. Geesman, congratulations.

16 The next item is --

17 Ms. George?

18 MS. GEORGE: The next items is Agenda Item
19 No. 5-E-1, and that concerns the consideration and
20 possible action on nominees to the California Power
21 Exchange.

22 CHAIRMAN KAHN: Mr. Willison?

23 The Electricity Oversight Board has been
24 instructed by -- or asked by the governor and we have
25 adopted resolutions which have made it clear that we

1 believe the FERC ought to intervene and protect the
2 California consumers and wholesale prices. As of
3 now, the Board is not satisfied that either the Power
4 Exchange or the ISO have taken sufficient actions to
5 protect the California Consumers. The Legislature
6 is, as we speak, addressing issues relating to the
7 wholesale market and how they're going to approach
8 the regulatory scheme. Under these circumstances, we
9 believe it inappropriate for us to confirm any
10 nominees for either of the boards. And that's my
11 personal view, and I believe that will be expressed
12 in the resolutions. We thought it only fair to tell
13 you what we're thinking and why we're thinking what's
14 going on. We intend, of course, to reevaluate the
15 situation in light of what the Legislature does today
16 and in light of the input of our legislative members
17 who are not here today.

18 Mr. Willison, do you have a motion?

19 MR. WILLISON: Yes. First of all, I'd just
20 comment that I echo your concerns there. Therefore,
21 the Board -- or I will move that the Board decline to
22 confirm the appointments for agricultural,
23 industrial, commercial and residential end-users and
24 the members for the public interest groups and then
25 decline to appoint members as end-users at large or

1 non-market participants to the California Power
2 Exchange governing Board.

3 CHAIRMAN KAHN: Second.

4 All in favor?

5 Aye.

6 MR. WILLISON: That motion passes two to
7 nothing.

8 Do you have a motion with respect to the ISO
9 members?

10 MR. WILLISON: Basically, the same motion with
11 the ISO members, namely, to decline to confirm the
12 nominees for the categories of agricultural,
13 industrial, commercial and residential end-users and
14 also the public interest groups and decline to
15 appoint members as end-users at large or non-market
16 participants.

17 CHAIRMAN KAHN: Second.

18 All in favor of the resolution?

19 Aye.

20 MR. WILLISON: Aye.

21 CHAIRMAN KAHN: That passes two to nothing.

22 MR. ROBINSON: Mr. Chairman?

23 CHAIRMAN KAHN: Yes.

24 MR. ROBINSON: If I could have some
25 clarification.

1 CHAIRMAN KAHN: Sure.

2 MR. ROBINSON: Are you deferring action or am
3 I to assume by that that we need to begin another
4 process to fill the vacancies on the board?

5 CHAIRMAN KAHN: Well, we are not deferring
6 action; we're declining.

7 MR. ROBINSON: Thank you.

8 CHAIRMAN KAHN: And so there will be another
9 process required. As to what that process consists
10 of, we would recommend that you confer with the EOB
11 staff after what -- give everybody the Labor Weekend
12 to digest whatever the Legislature does, and then on
13 Tuesday morning, I think, consultation by the Power
14 Exchange and by the ISO with EOB staff would be
15 appropriate.

16 MR. ROBINSON: Thank you, Mr. Chairman.

17 CHAIRMAN KAHN: And the EOB staff will be in
18 touch with the legislative members and with the
19 Administration during that period of time, also.

20 Okay. Mr. Heath?

21 MR. HEATH: Thank you, Mr. Chairman, Member.

22 We are moving to the next part of our agenda
23 which is our reports from both the California ISO as
24 well as the California Power Exchange. Leading off
25 on that report today is a report on the electricity

1 prices and market performance in the ISO markets from
2 May 1 through August 25. And I've asked Mr. Winter
3 and his staff to make that presentation today.

4 MS. SHEFFRIN: Good morning, Mr. Chairman.

5 CHAIRMAN KAHN: Would you introduce yourself,
6 please.

7 MS. SHEFFRIN: Yes. My name is Anjali
8 Sheffrin. I'm the Director of Market Analysis of the
9 California ISO.

10 CHAIRMAN KAHN: Did you write this report?

11 MS. SHEFFRIN: Yes, myself and my staff.

12 CHAIRMAN KAHN: Well, they did a really good
13 job.

14 MS. SHEFFRIN: Thank you very much.

15 CHAIRMAN KAHN: Thank you very much. It was
16 lucid and very helpful. So I want to express my
17 appreciation.

18 MS. SHEFFRIN: Thank you. Part of our job.

19 CHAIRMAN KAHN: Thank you. Go ahead.

20 MS. SHEFFRIN: What I have is a short
21 presentation giving an overview of the market
22 performance from May to August so you can see what
23 the impact has been of the various price actions and
24 how the market has performed overall. I do have
25 copies of my presentation which I've made available

1 to the audience. And after I get back to the office,
2 I will post it on the ISO website under the "Market
3 Analysis" heading.

4 CHAIRMAN KAHN: Okay.

5 MS. SHEFFRIN: What I'd like to do this
6 morning is, again, very briefly review for you recent
7 market performance in the ISO's markets, give you a
8 very initial impression of what impacts lowering the
9 price caps has had, the lowering the price caps from
10 \$750 in June down to \$500 in July, down to \$250, I
11 believe, starting August 7th. And we've had, of
12 course, a month of experience under each of those
13 regimes, so it is a short time, but I can still give
14 you the overall impression.

15 What I'd also, after reviewing market
16 performance, do for you is look at some of the
17 continuing problems that we have to deal with in
18 correcting these markets and a set of -- not a
19 complete proposed proposals, but a set of proposals
20 which is coming out of the Markets Surveillance
21 Committee as well as my group as a (inaudible)
22 wanting to correct the incentives that are causing
23 some of the problems in this market.

24 CHAIRMAN KAHN: Okay.

25 MS. SHEFFRIN: Turning to page 3, this is

1 trying to give you in one slide a picture of what's
2 happening to the markets. And it's -- what I have to
3 report to you is a mixed set of results of market
4 performance after we've lowered the price caps.

5 What I show for you is May, June, July and
6 August, the load levels that we've had to serve in
7 California. And although I'm showing you only this
8 year's loads, I need you to recognize that loads are
9 up 7 to 10 percent over last year. We've had a
10 booming economy and a tremendous amount of energy
11 consumption that we've had to serve.

12 CHAIRMAN KAHN: That's year to year?

13 MS. SHEFFRIN: Yes.

14 CHAIRMAN KAHN: What about year-to-year
15 weather?

16 MS. SHEFFRIN: Year-to-year weather?

17 CHAIRMAN KAHN: Was it comparable or was it --

18 MS. SHEFFRIN: No. Last year was much more
19 moderate weather, giving us a cushion of extra
20 reserves and more competitive outcomes than what
21 we've had this year. Reserves have fallen very, very
22 low. And due to tight supply conditions, essentially
23 even a market player that you wouldn't think would
24 have very much market power, you know, can, in fact,
25 influence the market price.

1 CHAIRMAN KAHN: How much of that 7 to 10
2 percent increase in load is attributable to weather
3 deviation?

4 MS. SHEFFRIN: I guess I would say a large
5 majority is. I would say 60 percent to overall
6 economic activity; 40 percent just off the top of my
7 head. I could come back with more firm numbers for
8 you due to higher weather.

9 CHAIRMAN KAHN: Well, I know that the people
10 who are participating in the Governor's Task Force
11 are very interested in understanding what the actual
12 load differential is. And if you can give us more
13 precise information and segregate out weather affects
14 from the economic activities, that would be very
15 helpful.

16 MS. SHEFFRIN: Okay. Weather normalization, I did
17 that in my past career as being a load forecaster.
18 It is a complicated job. We will certainly try to
19 help out in that effort.

20 MR. WILLISON: I do recall in your report that
21 you do try to break out the various factors from
22 weather to gas prices and that sort of thing.

23 MS. SHEFFRIN: Right. Right. We do.

24 And in June we found that, you know, gas
25 prices had risen, what I show in this report is it

1 really took a spike upward in the month of August
2 going from \$4.50 to \$7 all within a month. So that's
3 a big explanation. I haven't broken out all the
4 components of the cost increases for August.

5 What we found in June, though, was 20 percent
6 of the increase in cost was due to higher loads;
7 another 20 percent due to natural gas prices; about
8 15 percent because we were in a real scarcity
9 situation. And under those conditions, you do expect
10 the price to rise; then the rest of it due to market
11 power.

12 MR. WILLISON: I think you report -- maybe it
13 was the client report indicated that up until the
14 March time frame -- or, I guess, the second year of
15 operation, that your claim was that 88 percent could
16 be explained by these factors that we're talking to
17 absent market volume.

18 MS. SHEFFRIN: Yeah. So I think probably ISO
19 will address that.

20 MR. WILLISON: It just helps us focus on this.
21 Since that time, particularly during these summer
22 months, that when we've had very strong increases,
23 that it does put more emphasis on the question of
24 market power and not the other issues.

25 MS. SHEFFRIN: It does. Although, I do show,

1 as I go through my presentation, that with the lower
2 price caps, we have really nipped that market power.
3 And so now what you're looking at is a significant
4 cost of supply in increases that are very difficult
5 to control, the, you know, fairly robust demand
6 growth, hydro. We can't make it rain anymore. It's
7 not within our control. The natural gas prices
8 doubling in a period of a month. So they were high
9 already, you know, starting this summer, but they
10 really took off. And I have -- if you want to see
11 that, I have that in a graph on page 7.

12 Okay. So essentially what I have summarized
13 for you is loads in each of the months, what the
14 total cost of energy only procurement is, and this is
15 PX and realtime market energy. Obviously, we also
16 procure Ancillary Service reserves to maintain the
17 liability; that's given in the next column for a
18 total cost of wholesale energy and Ancillary Service
19 procurement. And then I've put it in a
20 dollars-per-megawatt hour just for energy and also
21 total.

22 As you can see if you just look -- glance at
23 any of these numbers, the mixed results that I'm
24 talking about are that Ancillary Service costs are
25 down. We did lower the price cap on replacement

1 reserves as well as the overall price caps. But
2 while Ancillary Service costs procurement are down,
3 our overall energy costs are moving up. And as you
4 can see, we've gone and made from \$61 per megawatt
5 hour and up to \$184.

6 So what this, you know, of course, makes us as
7 economists look at is, okay, what's happening? Is
8 the problem the price caps aren't working? You know,
9 what else can be done? And I think what you need to
10 do is step back and look at the market fundamentals
11 before you make a decision as to what to do to help
12 contain these costs.

13 So if you turn to page 4, this is just a
14 representation of what's happened to the cost of
15 procurement both on a monthly basis of billing
16 dollars in May moving up to 3 billion dollars because
17 loads were more moderate in July. But then loads and
18 hotter weather caused the cost as well as the
19 underlying cost of procurement to go, so that now
20 we're looking at August being about a \$4 billion load
21 of cost of procurement and the average unit cost of
22 that being about \$184. So I just graphed it for you,
23 the numbers on the previous table.

24 So the question is have lower price caps
25 failed to contain market costs? I think when we look

1 at the market fundamentals the answer is no. First,
2 we do have higher loads. So even though we've
3 lowered the price cap, the number of times that we're
4 hitting it, the amount that we're having to deliver
5 is causing us to have higher costs.

6 What are some of the reasons that we're still
7 getting higher costs as a result even though we've
8 lowered the price cap? Well, there are two forces at
9 play here: You are containing costs, but at the same
10 time, cost of delivering power is going higher. And
11 I've just listed out the reasons that cause that in
12 this market: A fundamentally robust economy causing
13 higher loads; higher gas prices, again, as I show in
14 the graph moving from \$4.50 to \$7 in August in the
15 time of one month. I've also been told that the cost
16 of emission credits has gone from 20 cents to \$20.
17 So all of those get rolled into production costs of
18 electricity. We also have much lower hydro this year
19 than last year, both in state as well as out of
20 state, and that has reduced the number of imports.
21 And as you'll recall, California is very much
22 dependent on imports in order to keep the lights on
23 and meet our energy needs.

24 There are some things that we're observing in
25 the market that I will tell that we can do something

1 about. We are seeing much more of what the ISO calls
2 underscheduling, and that means schedules are being
3 met in the day-ahead versus how much supply has to be
4 met in realtime. We are seeing a gravitation of more
5 and more both loading generation deciding to appear
6 in realtime. That causes tremendous reliability
7 problems. That is an issue that needs to be
8 addressed. The latest FERC order has said that we
9 need to address that problem immediately. So we have
10 some proposed solutions on that.

11 We also are seeing many more hours because we
12 aren't getting supply in hours of shortage and
13 scarcity causing high prices. Again, there are very
14 specific actions we can take to cure that problem.

15 In the end, if you're trying to solve market
16 power problems, you've got to make sure sufficient
17 supply is there. And so you've got to look at all

18 ways to provide incentive for new entry, accelerate siting
19 generation, aggressive conservation programs, upgrade
20 transmission, all of those things. That's your fundamental
21 tool against market power. This other stuff is short term
22 and Band-aid.

23 So whenever we're looking at fixes to this
24 market, we've got to look at and answer the question
25 is it fundamentally been an increase to supply in

1 California because that's our major problem.

2 And lastly, we do have market power problems,
3 and we are proposing some additional measures to take
4 there to help solve that in this market.

5 So just to summarize what I just said, we've
6 had higher supply costs, and those have outweighed
7 the impact of lowering the price cap. And that's
8 simply because we have two forces at work in the
9 market. We are trying to control costs by lowering
10 price caps and changing the way we procure Ancillary
11 Services, and that's helped. But the opposing
12 factors have been much stronger and have caused costs
13 to increase -- higher loads, higher gas price,
14 lower hydro imports and more hours of scarcity. So
15 the net result has been what you saw in the numbers,
16 which is increased supply costs which have outweighed
17 the impact of lowering the price cap.

18 And these are just data for your review. This
19 is what's happened to the pattern of natural gas
20 prices. I showed them to you both last year as well
21 as this year. If you look at June and July, it was
22 in the \$4.50 per MMBTU and now at the end of August
23 it's \$7. Tremendous increase that has to be
24 reflected in the costs of the market.

25 CHAIRMAN KAHN: What does that mean in terms

1 of -- translate per megawatt hours?

2 MS. SHEFFRIN: You know, I would say for those
3 marginal units that we need to run to provide power,
4 that's bringing it up to \$100 a megawatt hour.
5 That's just fuel costs not adding variable costs,
6 emissions costs, those other things.

7 CHAIRMAN KAHN: Fuel costs?

8 MS. SHEFFRIN: So just fuel cost production
9 for those marginal units that we need to run to meet
10 our load.

11 CHAIRMAN KAHN: And what's the cause of the
12 gas price raises?

13 MS. SHEFFRIN: I'm probably not the best
14 person on that one. I've been out of the country for
15 two weeks, so I haven't followed this. What I
16 believe is -- what I've heard -- and, again, you'll
17 find me -- I verify things three times before I
18 repeat them. But what I've heard is that there was
19 an outage on a pipeline causing prices to spike in
20 California. And, secondly, people are filling
21 reservoirs in anticipation of the winter season
22 coming.

23 CHAIRMAN KAHN: Okay. Thank you.

24 MS. SHEFFRIN: You're welcome.

25 If you turn to the graph on page 8, what you

1 see is -- what we're trying to look at here is have
2 lowering the caps helped mitigate some of the market
3 power that we have seen. And the answer that I would
4 come back to you with is yes. What I've done is
5 showed you what the prices have been at different
6 load levels. And, of course, we're most concerned
7 about what happens to prices at the -- above 38,000
8 megawatts. That's when things are really tight;
9 everyone is scrambling, 38,000 megawatts in
10 California. And that's when we saw the highest
11 prices, when you had a price cap of 750. When we
12 lowered it in July, you see they topped off at \$500.
13 So, you know, that was market power during tight
14 supply conditions, people charging what they may,
15 and we lowered that. So we have been successful.
16 And then when we lowered it to 250, again, you saw
17 those high prices during the highest load hours being
18 topped off. That was the fundamental phenomenon of
19 how much market power was being exercised in this
20 market.

21 So I think that at \$250, we are close to not
22 only variable costs of production, which is fuel and
23 OOM and emission credits, but also giving a return to
24 track new investment. And, again, remember, what
25 we're worried about and what our long-run salvation

1 will be is attracting new supply into the California
2 market. Everything else is a Band-aid and not, you
3 know, a fundamental solution. In the end we still
4 need to keep the lights on and to have sufficient
5 supply to do.

6 CHAIRMAN KAHN: What accounts for the delta
7 between the yellow line and the red line in the area
8 of before 35,000?

9 MS. SHEFFRIN: Before 35,000, the prices are
10 pretty much, you know, very similar -- the red, the
11 yellow and the blue.

12 CHAIRMAN KAHN: There's a significant delta
13 between -- it looks to be the red line is --

14 MS. SHEFFRIN: Oh. Okay. I'm sorry.

15 CHAIRMAN KAHN: The red line is hovering
16 about --

17 MS. SHEFFRIN: Right. What's happened is
18 after decreasing the costs, we have nipped the price
19 spikes and the high load hours, but it does look like
20 costs have gone up with the red line in the lower
21 load hours.

22 MR. WILLISON: Well, it's all those reasons
23 that you mentioned, the supply --

24 MS. SHEFFRIN: Right. Exactly. But
25 supplemental costs of supplying has gone up, and you

1 have to factor that in as well.

2 CHAIRMAN KAHN: Well, I can anticipate
3 arguments from some (inaudible) that would assert
4 that the reason the red line is uniformly high is
5 because of the price cap. Do you have a view on
6 that?

7 MS. SHEFFRIN: I think that there is some
8 amount of market power, but I would say that the
9 majority of it is the fundamental increases in costs
10 of production.

11 CHAIRMAN KAHN: So you would anticipate if
12 those variables were extracted that the red line
13 would approximate the yellow line and then jerk up to
14 the 250?

15 MS. SHEFFRIN: It should be lower.

16 CHAIRMAN KAHN: Okay.

17 MS. SHEFFRIN: Getting to the underscheduling
18 problem and evaluating and analyzing what's happened
19 to that trend over the months, what we're seeing is
20 underscheduling has increased slightly in the middle
21 hours; it's about the same during the highest peak
22 hours and the lowest load hours. But in that middle,
23 we are seeing higher amounts of underscheduling.
24 That is something that we need to act and
25 correct.

1 CHAIRMAN KAHN: Can you define
2 "underscheduling" for us?

3 MS. SHEFFRIN: Sure. There's two ways that
4 you can meet your electricity demand: Either have a
5 bilateral contract and contract for your demand ahead
6 of time, or meet it in the day-ahead market, which is
7 the Power Exchange market. Either of those; or you
8 can wait until realtime and, say, both meet your
9 needs and generation deciding. "I'm not going to
10 sign a contract ahead of time; I'll just take my
11 chances and produce in realtime and see the price I
12 get."

13 So typically this market was designed for, you
14 know, 3 to 5 percent of the load in generation being
15 met in realtime because there are all sorts of events
16 you can't anticipate. But what we're finding is more
17 like 16 to 22 percent have shifted and migrated both
18 load and generation and saying, "We'll get our needs
19 met in the realtime. It's got a price cap. We're
20 assured what price that's going to be, so, you know,
21 why negotiate a deal ahead of time?" Unfortunately,
22 that has a tremendous reliability problem. Our
23 operators are having to scramble to meet this large
24 unanticipated both generation and load showing up,
25 and it's something that we need to fix these ends so

1 both load and generation has the most incentive to
2 make their deals ahead of time, give us valid
3 schedules, not us scrambling to meet their needs or
4 accommodate generation at the last minute.

5 Okay. So of the factors that I've defined,
6 there were a number that are causing higher
7 electricity prices which are very difficult for any
8 of us to control no matter how much we wanted to.
9 And those are things like water availability, higher
10 demand, higher natural gas prices.

11 There are some factors, however, that we can
12 address and improve the performance of this market,
13 and they're in three areas: Underscheduling,
14 scarcity and tight supply conditions, and the
15 remaining market power that we should deal with. And
16 what I have for you is not the proposal by the ISO
17 because I don't think Terry has even seen this. What
18 I have for you is just a base case proposal by the
19 Markets Surveillance Committee in our group. And what
20 we're saying is we know these will help. Any other
21 proposals that we evaluate, we need to make sure they
22 help beyond these and don't hurt.

23 And so to deal with the underscheduling
24 problem, fundamentally the solution is to create a
25 disincentive to be in realtime for both load and

1 generation. And there have been a number of
2 proposals to try to create that incentive in this
3 market. One is to charge out-of-market calls to
4 underscheduled load. Right now they're spread as
5 peanut butter across all load. But really what's
6 causing us to have to go out and make those
7 additional purchases is because load didn't meet its
8 obligations and get them -- submit them to us. So we
9 say -- and I think there's general agreement that
10 that is a good thing to do is change the way we
11 charge our out-of-market purchase costs, not spread
12 them to everyone, to people who were balanced as well
13 as unbalanced but to people who were unbalanced.

14 So that will help give an incentive for loads
15 to say, "Don't show up in realtime. Cut your deal
16 before and show us what that schedule is. If we're
17 going to go do it, it's going to be high cost, and
18 we're going to charge it to you."

19 Second is charging replacement reserve costs
20 to underscheduled generation. Again, replacement
21 reserve is a joint outcome of both load and
22 generation coming to us, and it can be charged
23 equally. However, we feel that we want to discharge
24 generation from feeling that they shouldn't make a
25 deal ahead of time and just generate unannounced in

1 realtime. So charging generation this replacement
2 reserve will, again, be an additional transaction for
3 deciding to just wait until the last minute and show
4 up with generation. We want to encourage all of that
5 in the day-ahead market.

6 And then if those two things don't work, the
7 other means that has been suggested is to have an
8 additional charge for both load and generation for
9 transactions in the realtime market. So if you
10 choose to show up in the realtime, there's going to
11 be a tax to you of that activity because it costs us,
12 and there's a big reliability implication of your
13 actions.

14 So those are things that will help the
15 underscheduling that we see in the market, will help
16 reliability, and they should help high realtime
17 market prices. But they fundamentally don't address
18 the market power and scarcity issues. And still we
19 need to be sure and address those to get this market
20 working. So in order to -- you know, again, I'm sure
21 I'm speaking to the choir on the scarcity issue. We
22 have to do everything to attract new resources,
23 expedite it. That means aggressive development to
24 our conservation programs; that means accelerate
25 siting of generation and make sure that the

1 incentives that we're providing for new entry are
2 there. And one of the things that we don't keep
3 concerned about with constantly changing price caps
4 is investors will sit back and say, "We don't know
5 what the certainty is. Why should we invest in
6 California?" And yet that is the salvation we need.
7 We need that supply in order to meet our needs and
8 mitigate the price spikes that we've seen. And then
9 lastly to expand investment in transmission upgrades.

10 CHAIRMAN KAHN: How do you propose to do that?

11 MS. SHEFFRIN: The expand investment in
12 transmission upgrades?

13 CHAIRMAN KAHN: Right.

14 MS. SHEFFRIN: I think that -- Terry's ready
15 to order them to do it. I think we're -- the ISO is
16 going to look at where the transmission upgrade needs
17 are and submit a plan both to the Board and the
18 Legislature to say, "This is what's going to be
19 needed to" -- the transmission system wasn't built
20 for taking on transactions for a competitive market.
21 Now that we want to promote a competitive market,
22 let's make the upgrades and the infrastructure
23 necessary to facilitate that. So I do believe that
24 Terry Winter has a plan that will be submitted to
25 expand the transmission in the areas that it needs to

1 be done.

2 CHAIRMAN KAHN: If you can, Mr. Winter, in
3 light of this -- you don't have to do it today, but
4 by my lights, this is something that policy makers
5 are not focusing on and don't have a really good
6 grasp on, but it's a big problem. So we could really
7 use your guidance on this.

8 MR. WINTER: Yes, sir. I think in our Action
9 Plan we listed all the projects that were immediately
10 needed, and we're following up on those and reporting
11 back to you on the success that we're having on
12 those.

13 CHAIRMAN KAHN: Does the Energy Commission
14 have any jurisdiction over those?

15 MR. WINTER: Not the transmission lines.
16 Their jurisdiction is from the power plant to the
17 interconnection. And the PUC takes over as far as
18 the licensing of those lines.

19 CHAIRMAN KAHN: Okay.

20 MR. WILLISON: I was going to ask a broader
21 question which is do you have the authority to
22 implement these recommendations, at least
23 specifically the ones that relate to the load
24 charges?

25 MS. SHEFFRIN: We will have to make some

1 tariff filings, but I believe FERC is expecting
2 those -- in fact, in your last order, they have said,
3 "Do something about the underscheduling and make a
4 filing to us." So we will be preparing something
5 very soon.

6 MR. WILLISON: And so the process is that the
7 Board agrees -- basically, they're inflicting this on
8 themselves. The Board agrees that these are
9 appropriate steps, and then basically orders you to
10 file.

11 MR. WINTER: That's right. Then we file with
12 FERC for the tariff that allows us to change the way
13 we're spreading those costs.

14 MS. SHEFFRIN: In terms of the scarcity area,
15 I think that the governor is taking, you know, action
16 to help accelerate the siting process. And, you
17 know, development of price-responsive programs is
18 absolutely necessary as well in this marketplace. So
19 any problems from the CPUC which are preventing those
20 to happen we need to work in hand with them to make
21 sure that they understand how important their actions
22 are in the current market.

23 CHAIRMAN KAHN: At least the leadership of the
24 CPUC is aware of this and is on board.

25 MS. SHEFFRIN: Fantastic.

1 And then finally in the areas of continuing
2 market power that we need to address, we are taking
3 actions. We're going to file an extension for a
4 price authority at FERC. We have an action at the
5 Governing Board to do that this month. And what
6 we're asking for that authority to be is indefinite
7 until the markets are demonstrated to be workably
8 competitive.

9 The second is we would urge the CPUC to allow
10 the utilities to hedge or contract their full amount
11 of peak requirements. Right now it's just an average
12 peak. But, again, we feel that the utilities, they
13 need to take the action by bringing the requests to
14 the CPUC so they can act. So there are actions the
15 utilities can do themselves. You need to get going.
16 And that is going to be a very major way given the
17 tight supply conditions we have right now to mitigate
18 market power. If you forward contract with the
19 generator and he's decided to supply to you a fixed
20 price, he doesn't have the incentive to spike the
21 price. That's a fundamental mitigation that we don't
22 have in place that we need to.

23 We need to promote many more price-responsive
24 demand programs than we have right now. Again, we're
25 working with CPUC to get going on that. There were

1 some restrictions on those. And we are allowing a
2 \$750 credit to be paid, not just the \$250 price. So
3 that should help stimulate development in those
4 programs. And, again, fundamentally, suppliers can't
5 spike the price of demand and say no to higher
6 prices. So you need the ability for demand to say
7 no, and we haven't had that in this market thus far.

8 And lastly, the other reason that prices spike
9 is because we've fallen so low in our reserve
10 margins. When you have 15 percent reserve margin,
11 someone in the 5 to 10 market share can't spike the
12 price because he'll just lose market share if he asks
13 a higher price. But when you fall as low as, you
14 know, 3 percent, then someone as low as a 3 percent
15 market share can spike the price. So we've got to
16 have mechanisms that make sure that either the
17 utilities have demonstrated that they have the
18 capacity to fully cover their loads after the
19 tremendous amount load growth that's occurred. If
20 they don't do that, then the ISO may have to do that
21 as a backstop. And, again, we're looking at
22 mechanisms and developing them to see who should do
23 it better. Of course, we'd rather prefer that the
24 utilities do it ahead of time. What the ISO would be
25 doing is a backstop measure. So we are developing

1 those things as well to ensure that we have
2 sufficient planning in reserve markets. That helps
3 reliability, that helps market power. Right now
4 those reserve markets have fallen to woefully
5 inadequate levels in California.

6 So I think we're -- we have seen the trends.
7 I think we have addressed the areas that we can
8 address. We're taking serious steps. The rest of my
9 presentation is simply a concern about, you know,
10 further action on the price caps to just make sure
11 that whenever any new proposals are presented, we
12 definitely have to answer the question is it going to
13 help attract new entry, new investment in this market
14 or not? Is it going to help mitigate market power?
15 Any of these new things. So as a whole set of things
16 come forward to us, we will analyze it, but it will
17 have to be towards whether they're helping, you know,
18 solve the fundamental problems in this market.

19 CHAIRMAN KAHN: Okay. Thank you. I just have
20 one question. Do you have an opinion as to what the
21 relationship between the price cap and the marginal
22 costs ought to be?

23 MS. SHEFFRIN: The study that we did was that
24 at \$250 it's sufficient to both cover your costs,
25 your full production costs and give a return on the

1 investment or attract new entry.

2 CHAIRMAN KAHN: I'm sure that's true. But you
3 say here systems marginal costs is approaching
4 \$100 --

5 MS. SHEFFRIN: Or over \$100 if you add
6 emissions -- 120.

7 CHAIRMAN KAHN: A hundred and twenty?

8 MS. SHEFFRIN: Right.

9 CHAIRMAN KAHN: Why would a price cap twice
10 that be necessary?

11 MS. SHEFFRIN: I'm sorry, say that again.

12 CHAIRMAN KAHN: Why would a price cap twice
13 that be necessary?

14 MS. SHEFFRIN: Because those are just your
15 variable costs. You have to pay your fixed costs.
16 You have to pay your return on investment in order to
17 keep investment in California.

18 CHAIRMAN KAHN: Right. But what would happen
19 if the market costs were reduced because gas prices
20 went down and because hydro was more available?

21 MS. SHEFFRIN: Those will all help.

22 CHAIRMAN KAHN: Shouldn't they --

23 MS. SHEFFRIN: They're not here yet.

24 CHAIRMAN KAHN: Right. But under those
25 circumstances, shouldn't the price cap be lower?

1 MS. SHEFFRIN: I think that the fundamental
2 thing you have to look at is what is the incentive
3 you're sending out for new entry to come into this
4 market. And stable price caps is probably the
5 strongest signal that you can give. Remember, you
6 need this new entry; they don't need you. They can
7 go other places.

8 CHAIRMAN KAHN: You said that the ISO will be
9 requesting authority. Will it be requesting
10 authority for the 250 price cap or will it be
11 requesting authority for more flexibility?

12 MS. SHEFFRIN: It's more flexibility. Our
13 authority is tremendously flexible. It is to set it
14 at a level, you know, with the appropriate work done
15 to justify that level, but complete discretion. And
16 it will be to extend authority with continued
17 discretion.

18 CHAIRMAN KAHN: So the ISO could set the price
19 cap below 250?

20 MS. SHEFFRIN: It could, yes.

21 CHAIRMAN KAHN: Even then?

22 MS. SHEFFRIN: Even then, yes.

23 CHAIRMAN KAHN: Thank you. Thank you very
24 much. It was very clear and well presented.

25 MR. WILLISON: One quick question. Page 14

1 where you have the graphs of the out-of-market
2 purchase prices coming down dramatically, can you
3 tell me like in August, were we still the best
4 seller's market, or was there other parts of the
5 country that were paying higher than this near 250
6 rate?

7 MS. SHEFFRIN: You know, in terms of other
8 parts of the country, I haven't had a chance to look
9 at that. I think what I was trying to show with this
10 out-of-market purchases is we definitely have -- if
11 you'd take a look first at page 13, our out-of-market
12 costs have increased. If you look at it on a
13 per-unit basis, however, and compare it to our
14 realtime price, as our price cap has dropped, our
15 out-of-market purchase costs on a per-unit basis has
16 dropped as well. Right now I guess we're at the --
17 what I feel is the ragged edge of making sure we can
18 acquire out-of-market to keep the lights on, pay the
19 bills --

20 MR. WILLISON: That's the question, whether or
21 not -- if we're still paying more than anyone else,
22 we're going to get the supply even though we're now
23 paying only 250.

24 MS. SHEFFRIN: There are hours -- and that's
25 somewhat one of the reasons why off-peak prices have

1 gone up, that the BPA and others have been willing to
2 pay, you know, the 250 price to refill their
3 reservoirs.

4 CHAIRMAN KAHN: Okay. Thank you very much.
5 Mr. Heath?

6 MR. HEATH: Thank you, Mr. Chairman,
7 Member.

8 The next presentation is a Status Report is
9 from the California Power Exchange basically
10 reporting on the electricity prices and performance
11 of those -- of their markets in the same time periods
12 of May 1 through August 25. Mr. Sladoje is coming
13 forward for that presentation. It's their side of
14 the market.

15 MR. SLADOJE: Thank you, Mr. Chairman.

16 The Compliance Unit of the California Power
17 Exchange is completing a rather lengthy detailed
18 report on prices this summer, and the report will be
19 ready next week. We were rushed to try to get it
20 today, but we're not quite there. So what you have
21 here are excerpts from that report which, I think,
22 just generally outline the content of the report and
23 what it's going to say.

24 With me today from the Compliance Unit, the
25 manager of our Compliance Unit is Karen Koyano.

1 She's done the bulk of the work here, and she
2 certainly is in a better position to go through this
3 than I am. So Karen will go ahead.

4 CHAIRMAN KAHN: Thank you for giving us this
5 interim report, and we'd appreciate seeing the final
6 product next week.

7 MR. SLADOJE: You bet.

8 CHAIRMAN KAHN: Karen, welcome.

9 MS. KOYANO: Thank you.

10 Mr. Chairman, Member, thank you for the
11 opportunity to speak. My name is Karen Koyano, and
12 I'm the manager of Market Monitoring for the
13 Commission of the California Power Exchange.

14 I'd like to provide you with a summary of key
15 points from our forthcoming report on price movements
16 in the California electricity market from May through
17 July 2000.

18 As George mentioned, our report is expected to
19 be completed within about a week, and we expect also
20 to have a follow-up report in the fall for the
21 remaining of the summer.

22 In the first page there you see that the
23 day-ahead unconstrained market clearing price on an
24 hourly basis from May through July. You'll see that
25 the price spikes begin on May 22nd. And we have

1 approximately four -- three price spike periods
2 following that with increasing duration.

3 The average of May -- April market clearing
4 price was \$27 per megawatt hour; for May it increased
5 to \$47 per megawatt hour for the entire month; for
6 June it increased again to \$120 per megawatt hour;
7 and July it was 105 -- so a much higher price. You
8 can also see here the impact of the price cap from
9 750 and reducing down to 500 the beginning of July.

10 Now, the discussion of California price spikes
11 really begins not with California but within the
12 Western Systems Coordinating Council and other
13 reliability regions and power pulls within the U.S.
14 The Western Systems Coordinating Council is
15 responsible for ensuring reliability of the
16 interconnected transmission system from a region
17 extending from Canada to Mexico, from the Pacific
18 Ocean to the Rocky Mountains.

19 One measure of reliability is the amount of
20 reserve margin or cushion of safety to meet peak
21 demand conditions. On this graph here you see an
22 excerpt from a report from the Cambridge Energy
23 Research Associate -- CERA -- showing the reserve
24 margin or forecast margins for these different
25 regions and the associated spot prices that we saw in

1 1999. You can see that WSCC is down at the bottom at
2 about 17 percent reserve margin and very low spot
3 prices in '99. But you see here that starting about
4 a reserve margin of 11 percent, you start to see very
5 high spot prices across the U.S.

6 Now, the WSCC in 1999, again, was at 15
7 percent. What we're seeing in the year 2000 is a
8 significant erosion of that reserve margin. We'll
9 see in later slides here that the WSCC reserve margin
10 we estimate is down to approximately 5 percent. So
11 if you place the year 2000 actual reserve margin on
12 this graph, you'll see that at about 5 percent and
13 approximately a \$750 spot price, that WSCC is
14 within -- is showing patterns consistent with other
15 regions in the United States in terms of reserve
16 margin and spot prices. You'll see here that in many
17 regions the spot price increased to between 800 and
18 \$1,100 last year. So, again, WSCC is consistent with
19 what we're seeing in the rest of the United States.

20 The forecast reserve margin shown on the next
21 page for WSCC subregions, we see California, the
22 Southwest, the Rocky Mountain area, Northwest power
23 pull and then an average for all of WSCC. What this
24 shows is that in forecasts for the year 2000 we see
25 reserve margins that dip down in August to about 20

1 percent. Now, normally this would be considered
2 adequate reserve margin given certain assumptions on
3 load and outages and net imports. But what we're
4 seeing is that the forecasted is much different than
5 what we're actually getting because the assumptions
6 on things like loads and outages and net imports is
7 significantly different than what was forecasted.

8 On the next page we have historical
9 temperature rankings. This shows you that -- this is
10 a graph that shows the rankings of the different
11 areas in the United States for the past 106 years.
12 When you see that California and Nevada is a ranking
13 of 103 out of 106, that means that we're experiencing
14 this year in the time frame of May through July 103rd
15 highest temperature out of the last 106 years. And
16 another interesting point about this is that not only
17 is California and Nevada high, but the Southwest has
18 even a higher temperature ranking. The Southwest
19 shows that they're experiencing this year the
20 highest -- the second highest temperature over the
21 past 106 years. And, also, the Pacific Northwest is
22 showing very higher temperatures. So all across the
23 United States, basically, we're seeing very high
24 temperatures and very high loads.

25 The shortfall in capacities of margin or the

1 difference between the forecast and the actual is
2 really due to this increase in load because of the
3 high temperatures, but also the outages where we
4 experience significant outages of gas-generating
5 units that the WSCC forecast did not even
6 incorporate. And in addition, we're seeing less net
7 imports possibly due to the reduction in hydro in the
8 Pacific Northwest. The runoff is much less this year
9 than expected.

10 So all of these different factors in terms of
11 expectations for reserve margin this year did not
12 materialize, and that is one reason why prices are --
13 we're seeing higher prices and people are surprised
14 by it because we didn't come to expect these kind of
15 fundamental factors.

16 The decrease in exports/imports is shown for
17 CalPX market on the next page. This shows
18 essentially a comparison between May through July of
19 '99 and 2000. Essentially, net imports are --
20 Northwest and Southwest imports is about the same as
21 last year, and it comprises 15 percent of our total
22 requirements. However, this year, we've seen much
23 more exports from the CalPX market, which also
24 results in a reduction of net imports and a reduction
25 of supply in the market.

1 MR. WILLISON: Can I ask a question for
2 clarification? That's basically power generated here
3 in California being sold to these other markets
4 rather than put into the -- our own Power Exchange?

5 MS. KOYANO: That's right.

6 MR. WILLISON: Thanks.

7 MS. KOYANO: So as a result of the increased
8 temperature, reduced hydro imports or imports in
9 general and the increased the outages, we're seeing
10 California reserve margins dip down to 5 percent
11 actual as compared to a 40 percent or 26 percent
12 forecast reserve margin. And, again, the prices that
13 we're seeing in our market is reflective of what
14 we're seeing across the United States in terms of the
15 relationship between reserve margin and spot prices.

16 Another factor that has recently received
17 considerably more attention than it has in the past
18 is the environmental constraints that we're seeing in
19 our market. We think that that is one of the crucial
20 reasons why we're seeing higher marginal costs.
21 These environmental constraints are forcing
22 generators to either buy the NOX or "NOX" credits at
23 higher prices or operate within existing constraints.
24 If they do operate within existing constraints,
25 there's a possibility that the supply essentially is

1 not available. And if they do have to buy these
2 environmental credits -- NOX credits, then, again,
3 it's at a significantly higher cost.

4 In the earlier part of this year, these NOX
5 credits that were valued at about \$2 per pound,
6 currently they're valued at about \$40 per pound which
7 results in a price of about 200 to \$400 per megawatt
8 hour. So marginal costs could increase by almost
9 \$400 instead of the NOX credits depending on how the
10 unit operates. So that is a significant factor in
11 possibly the increase in prices.

12 Now, how do these fundamental factors affect
13 bidding behavior in the California Power Exchange?
14 Well, bidding behavior is influenced by these
15 fundamental factors and economic incentives. Buyers
16 are seeking to minimize their costs of energy by
17 allocating their load among the day-ahead bid and the
18 realtime markets. And, likewise, suppliers are
19 allocating their generating capacity among the
20 day-ahead, day-of, realtime, Ancillary Services and
21 bilateral market. And high prices are caused by an
22 interaction of the supposed supply and demand.

23 Now, speaking of demand, we've seen
24 considerably less demand offered in the PX market
25 during this summer than we had last summer -- I'm

1 sorry, supply this summer than last summer. This
2 graph shows you the relationship of the amount of
3 supply bid into our market with the ISO load
4 forecast. What you're seeing with this blue line is
5 that as the ISO load forecast increases for 1999,
6 we're seeing more supply to our market, and that's
7 what we would expect in a normal kind of market
8 condition. But in the year 2000, what we're seeing
9 is supply is actually decreasing in the very high
10 load forecast range in addition to just being
11 significantly less from last year. And this spread
12 between the '99 to 2000 gets even worse in July. We
13 see much less supply and much more -- much greater
14 reductions in the higher load range.

15 Another trend that we see with supply in our
16 market is the lack of responsiveness of supply to
17 price. In about \$100 megawatt price offer, there's
18 very little supply being offered at those prices
19 greater than 100. So we wanted to evaluate those
20 suppliers who are submitting bids around the market
21 clearing price to evaluate what suppliers are
22 essentially setting the price.

23 The Compliance Unit has evaluated those
24 participants by looking at their supply curve and
25 seeing which suppliers are providing price sensitive

1 bids around the market clearing price. And those
2 that are submitting these price-sensitive bids are
3 indicating that these suppliers are willing to supply
4 more if the price increase -- if they see a benefit
5 for them in price. We call these suppliers
6 "incremental suppliers" because they're supplying an
7 increment of energy around the market clearing price
8 that could affect their market clearing price as
9 opposed to price takers which essentially bid one
10 volume at any price. So they would not influence the
11 market clearing price.

12 When we do this enough, we see that -- we said
13 that there's no consistent pattern of individual
14 participants or category of participant that are
15 influencing the market price. We looked at different
16 price ranges from 100 to 750, and we see that at
17 different price ranges we have at times new
18 generation owners that are setting the market price,
19 and in other price ranges we see importers that are
20 essentially setting the market price. So we don't
21 see this -- a consistent pattern throughout this
22 whole summer of a particular participant or category
23 as the price setter.

24 The lack of supply in the CalPX day-ahead
25 market is largely due to the -- as Anjali had

1 mentioned -- large volumes in the realtime, Ancillary
2 Service markets and the out-of-market calls that are
3 essentially draining the CalPX market from the
4 supply. And the next three graphs I just wanted to
5 show you the volumes that are in these different
6 markets and how this volume could -- if it was bid
7 into the PX market could substantially influence our
8 price. In the realtime market we see a volume that
9 could be as large as 9,000 megawatts in one hour and
10 comprising about 21 percent of the ISO's actual load.
11 And the real -- in the replacement reserve market,
12 we're seeing that the quantity of replacement reserve
13 increases exponentially with the volume of load --
14 the different load. Excuse me. And that market we
15 see replacement reserves as high as 4,000 megawatts.
16 And, also, the out-of-market calls in the past
17 several months are significantly also draining
18 supplies essentially from the CalPX market.

19 Now, when we see prices reach the price cap in
20 our market, what that implies is that there isn't
21 enough supply to meet the demand in that market. When
22 prices reach the price cap, we're seeing that the
23 supply and the demand curves will not intercept
24 except for the price cap. And the result of that is
25 that there's a significant amount of demand that is

1 unmet in the PX market that is being forced to go
2 into the realtime or the day-of market. This next
3 graph here shows you on page 15 the relationship of
4 how much unmet demand is being shifted to the
5 realtime with -- as a function of the ISO load
6 forecast. So many hours we see 9,000 megawatts of
7 demand that we'd want to be satisfied in the
8 day-ahead market, but because there is insufficient
9 supply cannot be met. It's therefore shifted to the
10 realtime market.

11 Demand bidding behavior is also influencing
12 the price volatility in our market. On page 16
13 you'll see three different days in June, and you'll
14 see very different demand strategies for these three
15 different days. If you look at the supply curves,
16 you'll see how vertical supply curves are in this
17 case -- in these cases, which reflects very little
18 supply that's being bid into our market at higher
19 prices. If you look at June 13th demand curve,
20 you'll see that -- you'll see that that is -- you'll
21 see the elasticity of demand -- structurally induced
22 elasticity of demand on this day, and you'll see a
23 curve as it slopes from right to left. On that day
24 we experienced also very high realtime prices. And
25 on June 14th you'll see the impact of those

1 expectations of realtime prices by shifting of that
2 demand to the right, which indicates there is more
3 demand that wants to be satisfied in the day-ahead
4 market. Unfortunately, because of the lack of supply
5 and the vertical nature of the supply curve, there's
6 very little additional volume that is being supplied
7 in the market, just -- the result is just higher
8 prices. And, again, on June 28th, we see that demand
9 is bidding even more vertical, indicating their
10 desire to supply -- satisfy the demand in the
11 day-ahead market. But because of the lack of supply,
12 they were not capable of doing that.

13 So in general, we believe that fundamental
14 forces explain a considerable amount of the reasons
15 for the price spikes. And, also, bidding behavior
16 is -- the lack of supply in our market is also the
17 largest factor in terms of having higher prices in
18 our market.

19 The recommendations that we have in the
20 Compliance Unit proposal is essentially to create an
21 incentive to schedule load and generation in the
22 forward markets. We'd like to limit the allocation
23 of the out-of-market costs to participants who are
24 purchasing, who cause the out-of-market purchases to
25 occur. We think that we should raise the ISO

1 adjustment bid cap to equal what ISO charges to allow
2 demand to bid higher than the energy cap to
3 incorporate the risk of replacement reserve costs.
4 We think that the -- we should change daily blocks.
5 Daily blocks are in the block boards market. They're
6 a -- to deliver energy the next day at a fixed price.
7 In this case, we would not need to go to the
8 congestion management process. We would like to link
9 the realtime price to the day-ahead price in such a
10 way that scheduling in the forward markets occurs.
11 And one method to do that is to penalize unobstructed
12 deviations in the realtime market for both supply and
13 demand participants. We believe that sellers supply
14 and unobstructed deviation should receive lower of
15 the realtime price or the zonal price, and buyers
16 should pay the higher of the realtime price of the
17 CalPX price. I believe that George is going to
18 discuss that a little bit further. And, lastly, we
19 need to increase the emphasis on demand
20 responsiveness programs through various venues
21 including utility programs, tax law incentives and
22 encourage the PX to develop demand responsiveness
23 programs.

24 CHAIRMAN KAHN: Thank you very much.

25 Mr. Sladoje, do you want to add --

1 MR. SLADOJE: No, I think we're talking about
2 the underscheduling in a joint presentation with the
3 ISO. Thank you.

4 CHAIRMAN KAHN: Okay.

5 Mr. Heath?

6 Thank you very much, ma'am.

7 MR. HEATH: Thank you, Mr. Chairman and
8 Member.

9 The next item on the agenda is Item 6-C, joint
10 reports from the CalPX and the ISO on recommendations
11 for improving market efficiency. This is being
12 presented as a joint report hoping to further
13 cooperation between the two corporations on those
14 endeavors.

15 MR. FLUCKIGER: The Power Exchange and the ISO
16 have worked together looking at some things that will
17 help increase scheduling in the forward markets.
18 Anjali in her report talked about some of the
19 incentives necessary to cause that to happen. This
20 year -- this page here is a suggestion of some ideas
21 that are consistent with that and our suggestions to
22 begin that process and are consistent also with the
23 direction -- that are being looked at by both the
24 Market Monitoring Unit in the Power Exchange and in
25 the ISO.

1 What you just heard in the presentation
2 outlines the genesis -- or the crux of this issue
3 here, which really says make it more attractive to
4 suppliers to provide in forward markets and less
5 attractive for demand to show up in realtime markets
6 and by adjusting what they get paid. The realtime
7 market, essentially, was created really to cover only
8 about up to 5 percent, load forecasts there, that
9 kind of thing. That's all the realtime market was
10 ever designed to do. So what this proposal is -- and
11 this is not finished at all, but this is what was the
12 direction we were looking at, but it would require
13 some tariff changes and filing and so forth to
14 implement. The idea is to say if your load forecast
15 is within 5 percent, then the market functions as it
16 was designed. It's a balancing market. What you
17 pay in that market is exactly what the supply and
18 demand and current market structure dictate, and the
19 sellers would also be paid those prices for providing
20 energy in that realtime market. More than 5
21 percent -- in other words, if I'm a represent load
22 and more than 5 percent of my load shows up, then for
23 the amount greater than 5 percent I would pay the
24 greater of the PX forward price of the realtime
25 price. The idea being then that 5 percent becomes a

1 penalty or I'm paying more. For suppliers, its
2 inverse, to encourage them to be in forward markets.
3 They would actually receive the lesser of. So to the
4 extent they supply in realtime, they receive the
5 lesser of the forward price or the realtime price.
6 And both of those incentives, it incents both of
7 them to want to clear the forward market and have
8 those schedules done ahead of time.

9 There is one piece that's not mentioned here
10 that Anjali did mention, and that is we have a
11 replacement reserve allocation today that puts the
12 cost of replacement reserves -- I'll just briefly
13 explain what that is. When I see that
14 underscheduling that we talked about, I go out and --
15 one of my Ancillary Service markets and buy
16 replacement reserve. Today the cost of that
17 replacement reserve is primarily put on loads. And
18 there's a suggestion both as part of this and it's
19 what she suggested that there be an examination of
20 changing that, perhaps to put it on generators,
21 perhaps to split it, but not to take it all off of
22 loads. Because when it's all on one side, then it
23 creates a higher opportunity cost for generators to
24 go into realtime. So this is a suggestion.

25 And then the last bullet here is also to

1 change the adjustment bid cap, which was also
2 suggested in one of the two reports you heard earlier
3 to allow load to more accurately price its congestion
4 base in the forward markets.

5 MR. SLADOJE: Okay. The only other thing I
6 wanted to point out is that we are also exploring
7 what had previously not -- never happened, and that
8 is the ISO perhaps purchasing out of certain Power
9 Exchange markets. It's kind of a -- been kind of
10 a -- it's just something that's just never been
11 really considered. And some people have some real
12 problems with it and others encourage it. So we're
13 talking about feasibility and the reasonability of
14 perhaps it will help also with -- do away without
15 out-of-market purchases or severe shortages at
16 critical times.

17 MR. FLUCKIGER: The last --

18 MR. WILLISON: I'm sorry, is that the
19 long-term contracts or with out of --

20 MR. SLADOJE: Conceivably it could be both.
21 We have a five-year market now. So I suppose if they
22 found the price very attractive they might do it.
23 But I think initially we're talking about shorter
24 terms. But over the long haul it could be long term
25 as well.

1 MR. FLUCKIGER: The last -- one of the last
2 FERC decisions in the San Diego case, it had some
3 language in there that indicated that they were
4 looking for the ISO to "do something better" or do a
5 better job in terms of forward purchasing. And so
6 we're looking at possibly initially short term, but
7 what the role should be. Again, as Mr. Sladoje
8 indicated, there are those that have significant
9 issues with the ISO doing this at all. So we're
10 approaching this very carefully. But the idea is
11 what should the ISO do in terms of providing at the
12 best possible cost energy that it is required to
13 provide in realtime markets, and is there a forward
14 purchasing element that perhaps through the Power
15 Exchange could take place.

16 CHAIRMAN KAHN: Well -- I'm sorry, was that
17 all you had, Mr. Sladoje?

18 MR. SLADOJE: That's it.

19 CHAIRMAN KAHN: In terms of your efforts here,
20 it seems to me that to the extent you have consensus
21 between the two of you and you're going to go to
22 FERC, that we would like to be part of your process
23 and know what's going on, can help get a consensus
24 with respect to other interested California agencies,
25 and, if this makes sense, to put the full weight of

1 the California government behind this. Because
2 obviously it's addressing the exact issues that you
3 two just -- as your reports identified, were a
4 significant cause of the problems. To the extent you
5 do end up implementing this and you can measure the
6 value in terms of rectifying some of the problems we
7 have, that would be very helpful to us. And it's the
8 kind of metric that the Legislature, I think, is
9 going to be very interested in.

10 Clearly these issues are going to be discussed
11 over the next number of months. And to the extent
12 that the PX and the ISO are able to ameliorate some
13 of the pricing problems with these kinds of efforts,
14 that will be very helpful for the Legislature and the
15 Administration to know. So we appreciate your
16 efforts and also being kept informed.

17 MR. SLADOJE: Very good. We'll keep the
18 Oversight Board with us on this.

19 MR. WILLISON: Can I ask a question?

20 CHAIRMAN KAHN: Sure.

21 MR. WILLISON: The first two bullets really
22 would appear to be good disincentives to the
23 shortfall that we've seen. But I'm wondering in
24 these -- particularly in these periods of tight
25 supply, are we more likely to see, then, bids that

1 come in at the cap level in the day-ahead markets
2 much more quickly?

3 MR. SLADOJE: I think that is one of the
4 reasons we need to explore these with our respective
5 market monitoring groups just to try to anticipate
6 what the behavior is. Certainly --

7 MR. WILLISON: There is little risk today
8 particularly for California providers that there
9 supply isn't going to be utilized; correct?

10 MR. SLADOJE: That's correct. But if this
11 will encourage more supply into the day-ahead market,
12 perhaps it won't hit the cap as often as we have
13 been. But you're right, this is an issue we're going
14 to have to really deal with before we actually go
15 forward with something formal.

16 MR. FLUCKIGER: In periods of high supply, if
17 every megawatt's going to be used, it really isn't
18 going to make very much difference in which market it
19 shows up. If someone has the ability to charge
20 that -- if every single megawatt is needed, it's
21 going to be priced into this market or that market.

22 MR. WILLISON: Right. I'm just thinking -- it
23 was Karen's graph of the question that the Chairman
24 had that basically the red line was higher in the
25 earlier stages, and so the total cost was actually

1 higher even though the caps had come down, because
2 they were higher at much lower levels -- low levels.

3 CHAIRMAN KAHN: Thank you both very much.

4 Mr. Heath?

5 MR. HEATH: Yes. Mr. Chairman, there are
6 three remaining items on the agenda. With your
7 concurrence on this, perhaps we would move to the
8 Item No. F -- 6-F, which is the report on the
9 Comprehensive Market Redesign/Congestion Management
10 Reform proceeding that's currently going on before
11 the ISO. That is scheduled for one form of approval
12 next week. We have received a letter from
13 Mayor Willie Brown, city of San Francisco asking for,
14 I believe, one, a delay and a decision by the ISO
15 Governing Board on that matter, and also calling for
16 a study related to the rates that -- or the rate
17 implications or fiscal implications of those
18 proposals. We've asked the ISO to make a
19 presentation today on that market redesign efforts,
20 and then also, I believe, to respond to -- at this
21 point to Mayor Brown's letter of August 29th.

22 CHAIRMAN KAHN: I take it that you're
23 suggesting that the people that are responsible for
24 Item 6-D and 6-E be apologized to and told they're
25 off the hook?

1 MR. HEATH: I have made those apologies and
2 told them they would be called some other time.

3 CHAIRMAN KAHN: Fine. Needless to say we are
4 interested in those issues, but I'll accept your
5 suggestion with Ms. Willison's approval.

6 MR. WILLISON: (No audible response.)

7 CHAIRMAN KAHN: Okay. We'll go to 6-F.

8 MS. SCHMID: Good afternoon. I'm Elena
9 Schmid. I'm the Vice President of Strategic
10 Development and Communications at the ISO, and I'm
11 the executive sponsor of the Congestion Management
12 and Comprehensive Redesign proposal. With me is
13 Dianne Hawk. She's the co-leader of the project. And
14 together we'd like to give you a summary of what's
15 going on.

16 Let me walk through the way I'd like to
17 present things. I'm going to give you an overview of
18 how we've gotten to where we are. I'll walk through
19 the process both of what's happened up to now and
20 what we will do going forward. I'll ask Dianne to
21 summarize the changes that we're proposing and then
22 respond to questions that you have. So if we don't
23 go into enough detail, feel free to ask us
24 questions.

25 What I've given you is the memo that's gone to

1 the Board. As Mr. Heath indicated, this is going to
2 the Board for policy approval in the coming week.
3 This is the summary information that they've
4 received. We have also produced a number of other
5 documents that are referred to, but I thought the
6 summary information would probably be most useful to
7 you.

8 You'll notice on the agenda item that it's
9 called both a Comprehensive Market Reform and
10 Congestion Market Reform. Let me talk a little bit
11 about those two.

12 When we started the project, we started the
13 project as Congestion Management Reform, and that the
14 other issues that had been added to it. And the
15 other issues, some of which you've heard about today,
16 have been added to it recently. And so we're on two
17 different time frames, and you need to understand
18 that as you understand what's going to the Board in
19 the coming week.

20 We started out with an acknowledgment that the
21 California markets are not perfect. They certainly
22 are not working. There's every evidence that they're
23 not working. And so we looked at the two years'
24 worth of data that we have that say what's going on
25 with the markets, what's happened with our market

1 rules that allow the market to show us the kind of
2 results that it's currently showing us.

3 And in looking at the global issues, the
4 issues that -- some of which you've heard about
5 today, we're looking at the forward scheduling
6 requirements. You've heard a lot about
7 underscheduling -- we're just referring to it as
8 afford scheduling -- and the allocation of those
9 costs. I think that Dr. Sheffrin referred to them as
10 the OOM costs or the allocation of those OOM costs.
11 We're looking at system-wide market power mitigation.
12 Again, she referred to it in her description. We're
13 looking at an interim locational market power
14 mitigation effort. We're looking at long-term grid
15 planning. And we're looking at a new facility
16 interconnection policy. So those are the global
17 issues. Those are the issues that are in a longer
18 time frame, and those are not the issues that are
19 going forward next week.

20 The issues that we're going forward with next
21 week are concentrated completely on the Congestion
22 Management Reform. And when we look -- when we talk
23 about what's going forward next week, what we're
24 really asking for is just the policy framework. The
25 document that you'll see as part of the package is

1 the decision document that we're asking the Board to
2 look at. It has 44 items on it. Some of which we're
3 making a straight recommendation for; some of which
4 we're putting options out there for. We need those
5 kinds of decisions to be made in order for us to move
6 forward and to do the kind of cost analysis that the
7 city of San Francisco is asking for, in order for us
8 to do the tariff language development. So we're
9 asking the Board to do framework decisions. And then
10 on October 4th, which is the next Board meeting, at
11 that point we're going to present them with a cost
12 analysis as best we can do at that point -- and you
13 need to understand that we're changing the markets;
14 we're changing the way we're approaching things. And
15 so we're going to have to make some enormous
16 assumptions as we try to do a cost analysis and what
17 the implications are. And it's also at the
18 October 4th Board meeting that we will ask for some
19 policy decisions on the global issues. And then when
20 we go back to the Board at the end of October, which
21 will be, I believe, October 25th and 26th, it's at
22 that point that we'll have the tariff language
23 developed.

24 CHAIRMAN KAHN: Where would I find the fourth
25 quarter decisions?

1 MS. SCHMID: I believe it is Attachment A.

2 It's Attachment A, which will be the fifth --

3 CHAIRMAN KAHN: Got it.

4 MS. SCHMID: -- fifth one in -- fifth page
5 in.

6 So the Board is going to have a number of
7 times that these issues are going to be before it,
8 that this decision that's going forward next week is
9 not going to be the only decision -- the only time
10 that they will visit these issues.

11 Let me talk a little bit about how we've
12 gotten to where we are. We started, actually, at the
13 discussions way back in January. We talked to all
14 the stakeholders. And then given all that input from
15 the stakeholders, from talking within staff, we
16 basically put a team together within the ISO that
17 incorporates all aspect of the ISO, the client
18 relations, the regulatory, the economists, operations
19 people, the IT people. We put a team together that
20 included everybody that says, "Let's look at the
21 whole process and everything that's in front of us
22 and how all the interactions happen so that we can
23 provide a very global response to the issues." We
24 did that during the month of July.

25 During the month of August, we had a number of

1 stakeholder meetings. We produced a report at the
2 end of our design exercise, and we put that out for
3 public review. We had a number of interactive
4 meetings with the stakeholders. Now, as I say, we'll
5 go to the Board for policy direction. Then we'll
6 look at tariff language, and then we'll move to the
7 implementation itself.

8 CHAIRMAN KAHN: At what stage are those
9 proceedings were we people in the position of the
10 city of San Francisco eligible for comments.

11 MS. SCHMID: We've had, I believe, 14
12 stakeholder meetings in this whole process.

13 CHAIRMAN KAHN: You consider them a
14 stakeholder?

15 MS. SCHMID: Oh, yeah, we consider them a
16 stakeholder. I believe that they were at the
17 majority of them, if not all of them. We do have
18 sign-in sheets, so we have a fairly good idea of
19 who's presented. There were a couple of very
20 specific times in which we asked for formal comments.
21 We had given them a template on how to submit formal
22 comments. They submitted comments at that time. I
23 think we've had like 55 people who have submitted
24 written comments to us. So it's been a very
25 extensive interactive process. We have changed the

1 proposal because of the interaction that we've had
2 with people.

3 CHAIRMAN KAHN: Fine. I just want to satisfy
4 that they had the opportunity.

5 MS. SCHMID: Okay.

6 CHAIRMAN KAHN: Go ahead.

7 MS. SCHMID: Understand that the global issues
8 are there. I'm going to set them aside and talk for
9 just a bit about the Congestion Management because
10 that's what's in front of us right now.

11 When the scheduling coordinators approach the
12 ISO, they give us a balanced schedule. They say,
13 "Here's our load, and this is where" -- "this is our
14 demand. We're giving you both the supply and the
15 demand side," and it's a balanced schedule. We take
16 all those schedules that we get from the scheduling
17 coordinators. We run the system to say can the
18 system deliver that energy, pick up the energy where
19 starts, deliver it where it belongs. If and when
20 they give us the balanced schedules, they also give
21 us adjustment bids. They say, "In case there's a
22 problem, this is how much we" -- "the incremental
23 bids and the detrimental bids. This is how much we
24 will pay for us to stay on the flow. This is how
25 much at this point we want you to drop us off." So

1 they give us adjustment bids. We run the schedule,
2 and we make sure that the system is to stay clear.
3 But what that is, that emphasizes that -- what
4 congestion is is the allocation of the transmission
5 resources. That what you've heard about up until
6 now, all the previous hours that you've listened to
7 the fascinating market discussions has been about the
8 energy side. And what congestion is about is about
9 the transmission side and how do we allocate the
10 transmission resources that we have? What's the
11 prices that we send out there that people can decide
12 what works and doesn't work for them in order to get
13 their power through?

14 So our end goal has been to redesign the
15 existing Congestion Management approach to allocate
16 the -- and price scarce transmission resources
17 consistent across all time frames to run infeasible
18 schedules and mitigate locational market power. That
19 was the goal that we had set out ourselves. That we
20 wanted to cover all time frames and make sure that
21 they were consistent. That we wanted to prevent
22 infeasible schedules. And that we wanted to mitigate
23 locational market power all within the context of
24 setting accurate price signals.

25 CHAIRMAN KAHN: Where in there is

1 identification of the transmission resources as a
2 constraint on the ability to deliver load?

3 MS. SCHMID: When does the ISO let the
4 scheduling coordinators know?

5 CHAIRMAN KAHN: No. I'm trying to determine
6 from the state's perspective how we can get a handle
7 on understanding that particular problem. I think
8 that -- as I alluded to Mr. Winter earlier, I think
9 that there's a vague understanding that the state of
10 the transmission system is a constraint, but I don't
11 think there's a really specific understanding. And I
12 guess my question is where do we learn what that
13 is -- what the constraint situation is before we
14 identify -- before we work through the issues that
15 you just identified?

16 MS. SCHMID: I think that that was kind of key
17 to the basis of how we approached the proposal.

18 CHAIRMAN KAHN: Right. Where would we find
19 that?

20 MS. SCHMID: So the foundation of what we've
21 done as we looked at the different time frames in our
22 different markets is that we are using realtime
23 requirements. So what we're saying is that we are
24 going to publish two days ahead -- as I say, Diane
25 will walk through the markets, so I don't want to

1 start getting into the markets too quickly.

2 CHAIRMAN KAHN: Right.

3 MS. SCHMID: But what we're saying is we are
4 going to publish what the transmission constraints
5 are. We're going to -- we, the ISO, are going to
6 commit to make all that information public so that
7 the market knows where the constraints are. The
8 market will know how much energy we need within a
9 certain area in order to allow new transmission -- in
10 order to allow new energy to come across the lines,
11 how much energy we need to come across those lines.
12 So we're going to publish what the operators use
13 which are called "Nomograms."

14 CHAIRMAN KAHN: When is that going to happen?

15 MS. SCHMID: It's going to start in the
16 two-day-ahead market. You mean when does this whole
17 idea start happening?

18 CHAIRMAN KAHN: No. You said you were going to
19 publish the constraints. When is that going to
20 happen?

21 MS. HAWK: I think there are two different --
22 one question and a different answer, and they're not
23 matching, I think.

24 MS. SCHMID: Okay.

25 MS. HAWK: If you are asking how do we know

1 where transmission upgrades need to be made?

2 CHAIRMAN KAHN: What I'm asking is a lot
3 dumber question than you're answering. I think that
4 having labored in this field now for the last three
5 months pretty intensively, I think as to some things
6 there's a very good understanding among the policy
7 makers. I think the siting issues are fairly well
8 understood. I think the parameters of the pricing
9 and the issues are pretty well understood, witness
10 the fact I think we understood the reports we just
11 heard. I think there's a vague understanding among
12 the policy makers that the transmission system is
13 constrained on the ability to deal with the really
14 increased demands, and that that transmission system
15 causes things like rolling black-outs even if generation
16 is available. But I don't think there is an
17 understanding among the policy makers what -- one,
18 what those constraints are and, two, what upgrades or
19 augmentation and, of course, the costs are required
20 for those things.

21 MR. WILLISON: If they're waiting for
22 wireless.

23 CHAIRMAN KAHN: Yeah. You're going to have
24 wireless soon? Well, assuming you don't have
25 wireless soon, I just would suggest that that part of

1 the learning curve is very far lower than the
2 learning curve on these other issues. And I would
3 repeat again the request through you, Mr. Winter, the
4 better you can help educate all of the policy makers
5 on this, the better we'll be able to understand what
6 you folks do and process this information; okay?

7 MS. SCHMID: I think that's right. Let me
8 just reiterate so I'm sure that I understand. What
9 we're doing is we're starting from a point that says
10 you all understand how the transmission system works.
11 And what you're saying --

12 CHAIRMAN KAHN: Yeah. That's a smart
13 assumption.

14 MS. SCHMID: -- is that's a big assumption.
15 Got it. Got it. Okay.

16 There is a whole process that's part of our
17 long-term grid planning in which we receive all the
18 information from the utilities on what they're
19 proposing for their upgrades. We understand what the
20 needs are now that we're running the total system.
21 We mesh those two. We will, indeed -- I think
22 probably we should think about coming forward with a
23 whole presentation on how the long-term grid policy
24 planning process works and what does it involve and
25 how do we move forward through it is what I'm

1 hearing.

2 CHAIRMAN KAHN: Okay. Go.

3 MS. HAWK: I just wanted to make a link
4 between what Elena has just said and the discussion
5 we were getting into. Every day, the day ahead of
6 the operating day we look at -- as Elena said,
7 schedules come in for supply to meet demand, and we
8 compile those and see if collectively the
9 transmission system can transport those flows. If
10 they cannot, we go through the process of congestion
11 management, and that is allocating those scarce
12 resources, bringing the schedules down to a level
13 that the transmission system can accommodate them.
14 So on a daily basis we go through that. As you look
15 over time -- that's sort of the use -- the day-to-day
16 use of the transmission system. As you look over
17 time and over the system, you look for patterns of
18 congestion and the growth and congestion. And what
19 we have in Congestion Management is a price is set.
20 And so as congestion increases, the price goes up.
21 And the idea is that that signals the need for an
22 upgrade. And I think in the Congestion Management
23 process that we're talking about, you will see there
24 is a great deal of information on congestion and what
25 that looks like.

1 The action plan that has been referred to has
2 an entire section on transmission upgrades that are
3 necessary. And so there is the long-term of needing
4 to upgrade the infrastructure. And we're talking
5 about the price signals that you get to incent that.

6 CHAIRMAN KAHN: Got it.

7 MS. SCHMID: Let me just add one or two more
8 quick things, and then Diane can walk through this
9 stuff.

10 Part of the reason that started this for us
11 was that FERC -- the Federal Regulatory Energy
12 Commission -- indicated there were some major --
13 excuse me -- flaws with our Congestion Management as
14 it was -- as it currently is used. And that the two
15 flaws that they identified were that there were
16 infeasible transmission systems -- I'm sorry,
17 infeasible transmission schedules in the day-ahead
18 market, meaning scheduling coordinators were giving
19 us things but it was based on financial transactions
20 not on physical transactions; and that there was a
21 failing to mitigate market power. So those were the
22 two issues they identified.

23 As we began to look at it, we added two issues
24 to it, which was that the realtime balancing energy
25 prices did not reflect the transmission constraints

1 and that we did not -- and that the market did not
2 have sufficient information to -- for the market
3 participants to make decentralized decisions in the
4 operations of their systems or the investments that
5 they should make, which ties into what Diane was
6 saying.

7 Again, I just want to reemphasize the
8 principles that we used as we moved forward, and then
9 Diane can walk through the changes.

10 We started from the basis that we should be
11 using realtime operation requirements as the basis,
12 and that meant that what the operators of the
13 transmission were seeing should be the same thing
14 that the market is seeing so that they understood how
15 the system operated and how they could have the
16 markets help the system. That had been disconnected
17 before, and so that's a major change and should
18 result in more feasible schedules and clearer
19 direction on both sides.

20 MR. WILLISON: Can I ask you just on that
21 point, does that run the risk, though, of some
22 providers being able to game the system, to load up
23 on a particular switch, particular line?

24 MS. SCHMID: I think that what we're assuming
25 is that as we make the whole process more transparent

1 and more public -- because all of this will be out
2 and in the public, that it will be much more
3 difficult for gaining to happen. So that everyone's
4 going to have the same information. They're going to
5 have to go through the same markets in the same time
6 frame. So, in fact, it should help.

7 The second principle was to allocate and price
8 the scarce transmission resources consistently across
9 all the market time frames, which creates an accurate
10 locational price signal and should eliminate the
11 infeasible transmission schedules. And finally, a
12 requirement on the ISO that we provide adequate
13 information for the market to self-manage congestion,
14 trade, bid and to schedule efficiently.

15 And with all of that, let Diane walk you
16 through the summary of the changes that we're
17 proposing. And this, I believe, is on page 5.

18 MS. HAWK: It's the second document, page 2.

19 You had asked the bulleted items that we were
20 giving to the Board, asking for their approval, it's
21 on page 2 of that document.

22 CHAIRMAN KAHN: Is being called Caption A?

23 MS. SCHMID: Yes, Attachment A.

24 CHAIRMAN KAHN: Starting with Locational
25 Pricing Units?

1 MS. HAWK: Yes.

2 CHAIRMAN KAHN: Got it.

3 MS. HAWK: That's it. This page just
4 summarizes the changes to the Congestion Management
5 process that result from following the design
6 principle that Elena just set out. It's looking at
7 realtime requirements, what do the operators need in
8 order to maintain system reliability, and what
9 behavior do you want to provide an incentive for,
10 what do you -- what actions do you want market
11 participants to take to be consistent with what the
12 operators need.

13 In terms of Congestion Management, what that
14 comes down to is wanting to price scarce transmission
15 resources that we see in realtime, that those
16 operators have to manage around. We want to price
17 those in all forward time frames.

18 So the first change to our current Congestion
19 Management process is the number of prices --
20 transmission prices that you see. As we reflected on
21 what happens in realtime, we see that we have been
22 using three basic areas to price -- three
23 transmission interfaces internal to California.
24 There are others external connecting California to
25 the rest of the West. But internally we have used

1 three. What we found -- operationally, what we
2 really use is somewhere in the area of 11. There are
3 approximately 11 areas that are connected. The
4 interfaces across which are scarce -- we would call
5 scarce transmission capacity that you see congestion
6 on across those.

7 CHAIRMAN KAHN: I don't mean to interrupt you,
8 but I think we're approaching the level of technical
9 detail that's certainly escaping me. And I -- I
10 would like an answer to the question -- I'll just
11 read from Mayor Brown's letter. He says, "Under the
12 ISO proposal, consumers in the Bay area could be
13 subjected to significant increases in prices they pay
14 for electricity." The question is is that right?
15 And why?

16 MS. HAWK: The answer is two part. The ISO,
17 as a central figure in the wholesale market, we've
18 been directed to provide better locational price
19 signals for transmission to provide these very price
20 signals to indicate when there is scarce
21 transmission. When we send those prices, when we
22 incur costs and then we allocate them, we allocate it
23 to scheduling coordinators, also wholesale actors.
24 Those wholesale scheduling coordinators then have to
25 figure out how they're going to allocate those costs

1 to the parties they do business for.

2 I think in this part of -- I think the letter
3 is addressing particularly the local reliability
4 requirements that we have to meet. And the answer to
5 that is that the costs that we incur will eventually
6 be distributed to each of the current UDCs, each of
7 the utilities. And it will be up to those UDCs and
8 the Public Utilities Commission to decide how to
9 allocate those geographically across the service
10 territories.

11 CHAIRMAN KAHN: Do I take that to be a yes?

12 MS. HAWK: It will be determined -- it is up
13 to the PUC, the costs -- how those costs are
14 allocated and whether or not there are locational --
15 whether San Francisco sees that price
16 difference.

17 MS. SCHMID: Let me add that there's a tension
18 that goes on here. And the tension is if you were to
19 send the absolute strongest price signal that you
20 could send to those areas that are transmission
21 constrained -- San Francisco, San Diego -- that,
22 indeed, we could probably say pretty definitively
23 that prices were going to go up. We also understand,
24 however, that now is probably not the time to send
25 the strongest possible signal. So we have kind of

1 modified our proposal. That instead of it going
2 directly to that particular area, that it's going to
3 go to the scheduling coordinator or to the UDC to the
4 utility company, which means it is going to be up to
5 the utility company to decide whether all customers
6 in the utility company are going to pay or just the
7 customers of that particular location.

8 CHAIRMAN KAHN: Let me see if I understand.
9 You're trying to make the system more -- the prices
10 within the system more reflective of the costs, and
11 that, in turn, is more reflective of the limitations
12 or abilities of the transmission systems in
13 particular areas; right? That's what you're trying
14 to do.

15 MS. HAWK: Uh-huh.

16 MS. SCHMID: Correct.

17 CHAIRMAN KAHN: And Mayor Brown sounds like he
18 is seeing that coming and feels that there is a
19 limitation on the system which would naturally result
20 in greater costs to his constituents. Is that fair?

21 MS. SCHMID: That's correct.

22 CHAIRMAN KAHN: I think that -- let me put it
23 this way: I get it. And the question is what to do
24 about it. I think that Mayor Brown's point that
25 before this happens or while it is happening that the

1 magnitude of the price increases ought to be
2 identified is one that's well taken.

3 MS. SCHMID: Correct.

4 CHAIRMAN KAHN: I don't think it's a
5 satisfactory answer to say, well, PG&E and the PUC
6 will figure out what that is because that's too much
7 of a black box to deal with it. I also think that
8 this particular dimension of cost increases is one
9 that the Bay area citizens legitimately would want to
10 have on the table in the debate. There is a debate
11 currently going to in Legislature about how much, if
12 any, money should be allocated to San Diego to
13 mitigate the affects of their predicament. And I
14 think Mayor Brown would like to know how much money
15 can or should be allocated to deal with the
16 predicament in San Francisco.

17 One other aspect of this, as a policy matter,
18 it is a lot more beneficial for -- at least from my
19 perspective as a policy maker, to spend money
20 upgrading systems like the transmission system and
21 fixing them -- that's much better spent money than to
22 pay for increased costs of energy which you don't get
23 anything for it other than the energy you would have
24 purchased. And we've spent all summer doing that,
25 and we've decided that's not much fun.

1 So in what you're doing, I think it's really
2 important that you are sensitive to those dimensions:
3 One, the additional cost, and, two, how we can
4 eliminate those costs by dealing with the
5 transmission system.

6 What Mayor Brown is suggesting is he doesn't
7 understand all of this -- and obviously neither do
8 I -- but that he sees something bad coming down the
9 road. And I really think that one of the questions
10 of the efficacy of the ISO system in this state is
11 whether the ISO will be able to be responsive to
12 these concerns and, one, produce the data of what the
13 costs will be, and, two, let the policy makers
14 understand what the capital costs would be to
15 eliminate that operating cost.

16 Can you help us on those things, obviously not
17 today, but soon?

18 MS. SCHMID: I think that actually we can
19 probably help you on part of it today, and part of it
20 is obviously a little more (inaudible).

21 We have done two extensive cost studies that
22 have been out there in the Congestion Management and
23 it deals with something that we won't go into, but
24 it deals with one of the underlying policy issues
25 which is called "market separation," and that has a

1 cost affect. We did an extensive analysis of that.
2 We have right now -- the ISO has what's called
3 "Reliability Must Run Units." Under the proposal
4 that we're putting forward to the Board, we will not
5 have to pay those energy costs. And so we have done
6 a cost analysis of how do those costs switch to the
7 areas that we're talking about.

8 The third cost study, which is the one that
9 Mayor Brown's asking for, is the cost study that says
10 what does it mean to people in my neighborhood, and
11 that's the cost study that we are going to attempt to
12 do for October 4th. What's the realtime cost that's
13 going to go out there? And we will attempt to do
14 that. And the reason I say "attempt" is because if
15 you look at the study afterwards, what you'll see is
16 we are going to have to make some major assumptions
17 on how the market is going to respond to our new
18 design. We will make those assumptions. We will put
19 out some scenarios on what the cost range could be,
20 and that's about the best that we're going to be able
21 to do.

22 CHAIRMAN KAHN: I take it that nothing
23 irrevocable is going to happen before that
24 information is made public.

25 MS. SCHMID: That's right. I tried to lay

1 that, in fact, this is going to go to the Board at
2 least three times, and that each one of those times,
3 as they get more and more information, they are going
4 to be able to make a change if they want to.

5 CHAIRMAN KAHN: I have no doubt that the
6 Legislature, the Governor and Mayor Brown would like
7 as much of that information as soon as possible. And
8 as far as our Board is concerned and our agency is
9 concerned, we would be happy to help work with you in
10 preparing that data in a fashion that laypeople can
11 understand, acknowledging that you're the experts,
12 and maybe the best thing that we can do is just help
13 the communication process.

14 MS. SCHMID: Thank you.

15 CHAIRMAN KAHN: But I think it's very
16 important that the policy makers, certainly in the
17 Legislature and in the Administration, understand the
18 answers to Mayor Brown's questions as soon as
19 possible. And in terms of responding to Mayor Brown,
20 I think it's important that he understands what the
21 time frame of what things are going to happen to him
22 are in addition to the other pieces of
23 information.

24 MS. SCHMID: Okay.

25 CHAIRMAN KAHN: Mr. Heath, does that respond

1 to the concerns that you had when you teed this up?

2 MR. HEATH: It does, indeed. I think it also
3 sets sort of in motion for future changes in
4 operations at the ISO, the Exchange, and future
5 tariff changes that we really do need to be very
6 mindful of what those implications are on the
7 California rates. And it should be always a factor
8 that's placed before both Governing Boards before
9 decision making, certainly back to the states so we
10 have an idea of what those implications are going --
11 what it would be if they were actually implemented.
12 This certainly tees this up just the way that I would
13 like to have it teed up. And on this particular
14 issue, because the implications here are rather great
15 in terms of these changes -- rather profound, I
16 should say, and I think we need to be very mindful if
17 the state's going to support those matters being put
18 forward by the ISO that we do understand very clearly
19 what those rate implications or those cost
20 implications are. And this is certainly one that I
21 really greatly appreciate you taking time on the
22 agenda to hear this matter because it's very
23 important to us.

24 I also believe -- I don't know if the Public
25 Utilities Commission's staff -- Malcolm -- had any

1 comment on this, but they also had shared the same
2 concerns as we did on this.

3 CHAIRMAN KAHN: Okay. Well, I think that's
4 right. And I'd like to bring this to a conclusion
5 with three maybe observations or action items.
6 Number one, we are going to write back Mayor Brown
7 that it is the sense of this Board that the ISO will
8 be responding to their concerns, and we're going to
9 invite Mayor Brown to continue to express his
10 concerns to us if he doesn't feel that's satisfying.

11 The second thing, again, to Mr. Winter, I
12 think the sooner that you can communicate to the
13 state the transmission upgrade needs and the cost of
14 them, the better. We are currently trying to figure
15 out what the load is going to be next year and what
16 additional supply we are going to have to find, if
17 any. And that doesn't do us any good at all if it
18 turns out that because of the transmission system we
19 either can't absorb it or, worse, because of the
20 deteriorating transmission system we're going lose
21 load. And so it's really important. As far as I
22 understand it, you folks are the best at figuring
23 those questions out, and we need that. And then
24 Mr. Heath needs to provide that information to the
25 Energy Commission and to the PUC and the other

1 members of the Task Force. So we appreciate that.

2 And then the third piece of it is simply that
3 the information that I have indicated we really need
4 to develop needs to be developed as soon as possible
5 because there will be a debate in the Legislature,
6 there is no doubt, the next time they meet as to what
7 to do about the entire problem, and there will be
8 discussion of what areas need to be addressed with
9 either money or other activities. And it's really
10 important that this piece that you're working on is
11 adequately communicated.

12 Mr. Willison, do you have anything to add in
13 this area?

14 MR. WILLISON: No.

15 CHAIRMAN KAHN: Unless you two have some other
16 burning information, I think you told us all we can
17 absorb.

18 MS. SCHMID: Thank you very much.

19 CHAIRMAN KAHN: Thank you very much for your
20 report and your help.

21 Mr. Heath, are we now done?

22 MR. HEATH: I believe if you have a motion to
23 adjourn -- strike that.

24 Yeah. Any final public comments should be
25 called forth.

1 CHAIRMAN KAHN: That's right.

2 Any other final public comment?

3 Looks like there are none.

4 MR. HEATH: Then you'll need a motion to
5 adjourn.

6 MR. WILLISON: Move we adjourn.

7 CHAIRMAN KAHN: I'll second.

8 All in favor?

9 Aye.

10 MR. WILLISON: Aye.

11 CHAIRMAN KAHN: The meeting is adjourned.

12 Thank you very much, everybody.

13 (The hearing was concluded at 1:33 p.m.)

14 ---oOo---

15

16

17

18

19

20

21

22

23

24

25

1 R E P O R T E R ' S C E R T I F I C A T E

2

3

4

STATE OF CALIFORNIA)
5) SS.
COUNTY OF SACRAMENTO)

6

7

8

9

10

11

12

I, SANDY HOPPER, a certified shorthand
reporter, do hereby certify that the foregoing 139
pages comprise a full, true and correct transcription
of the proceedings had and the testimony taken at the
hearing in the hereinbefore-entitled matter.

13

14

15

16

17

18

19

20

21

22

23

24

25

SANDY HOPPER, C.S.R.

C.S.R. NO. 7110

